

USAID

BUREAU FOR EUROPE AND THE NEW INDEPENDENT STATES (ENI)

FY 2000 BUDGET SUBMISSION (BBS)

1998

I. ENI FY 2000 BBS: SUMMARY

The past year has been a year of continued progress in transition towards democratic, market-oriented economies for almost all ENI countries. Our vision for the year 2000 and beyond is that of programs in which for most countries, the fundamental effort of government-led policy reform is well advanced, and the challenge is to deepen and sustain the transition through grassroots and community-based programs. Our partners-- non-governmental organizations, professional associations, business groups, regional and local governments, advocacy groups, credit providers, independent media -- will serve as increasingly effective mechanisms to assure broad participation by citizens in the fruits of political and economic change, to demand transparency and accountability from government, and to press for appropriate corporate governance which respects shareholder rights and public responsibility. Large scale traditional technical assistance to central government reformers, so necessary to initiate the pathways of market democracies, will diminish in most countries as we emphasize support to citizens organizations and regional initiatives as they forge sustainable and effective institutions.

In Europe, our geographic shift will be complete as the Northern Tier countries of Hungary, Poland, Latvia, and Lithuania all successfully graduate from bilateral assistance programs by the end of FY 2000, joining previous graduates Slovenia, Estonia, and the Czech Republic. In addition, the Slovakia bilateral program will also end in this period although more progress is needed on aspects of the democratic transformation. Modest future efforts in these countries under regional mechanisms will be devoted to sustaining the transition and strengthening partnerships with the US and within Europe.

This will allow us to focus requested FY 2000 SEED funds of \$382 million (a decrease of 18% from the amount requested in the FY 99 CP) on the Balkans and Europe's southern tier countries of Macedonia, Bulgaria, Romania, and Albania. Here, 46% of the funds requested (\$175 million) will be for Bosnia, where 1997 marked the second peaceful year following three and a half years of war, and where USAID is playing a major role in supporting implementation of the Dayton Accords. In the southern tier countries, progress in transition has lagged in the past, but new governments elected in the past 20 months in Romania and Bulgaria are demonstrating the commitment to aspects of reform that are expected to enable these countries to graduate from bilateral assistance in subsequent years. The new government in Albania is setting that country again on the much longer path necessary for it to one day reach the economic and political maturity of its European neighbors.

In the NIS countries, in 1997, for the first time since transition began, the region experienced positive growth in GDP as earlier USAID supported reforms led to expansion of the regional economy. And, in 1998, all NIS countries are expected to experience GDP growth greater than one per cent. Inflation, though high by US standards, has been brought under control and was 17% in 1997 and the economies are beginning to look outward as exports to non-NIS countries increased 16% while trade within NIS increased only 2%. Still, the economic transition is far from complete in the NIS region: average income in the NIS countries is only 55% of pre-transition levels, informal economies are large and growing, much of the economy in some countries remains to be privatized, and life expectancy remains below pre-transition levels.

In the democracy area, progress also has been slower than in Europe, although there has been little political backsliding in the past few years and, according to Freedom House, there have been improvements in Azerbaijan, Georgia, Moldova, Tajikistan, and Uzbekistan. Again, as in the economic area, much remains to be done.

To further the transition in these countries, ENI seeks \$925 million from the FREEDOM Support account for FY 2000. These funds will be used to help Russia as it goes through the advanced transition stage of consolidating reforms; Kazakhstan, Kyrgyzstan, Armenia, Moldova, Georgia, and Ukraine, as they continue with the earlier transition phase of deepening of reforms; and Azerbaijan, Belarus, Tajikistan, Turkmenistan, and Uzbekistan as they continue with efforts on the first stages of transition - breaking up the old system.

We will be providing this assistance increasingly through Partnership for Freedom activities that encourage lasting ties between NIS countries and the U.S. and that support mutually beneficial relationships which will leverage additional private, governmental and community resources for investment in transition. This will be accompanied by a continued shift in focus, emphasizing assistance to local communities and grass roots democracy rather than to major cities and central governments.

Our ESF request of \$34.6 million will continue support to bi-communal reconciliation in Ireland and Cyprus and DA funding of \$4 million will continue family planning efforts in Turkey.

The graduation of a number of countries coupled with stronger overseas missions will enable us to reduce ENI staffing over the next two years, particularly in Washington. Direct hire staff will decline from 263 in FY 98 to 238 in FY 2000 with the reduction of 25 USDH in ENI/W. Similarly, ENI/W PSC staff will decline from 91 in FY 98 to 71 in FY 2000. Overall staffing in all categories will be reduced by 137 employees (11%).

These reductions will allow us to virtually hold the line on OE requirements in both FY 99 and FY 2000. Our Washington OE needs will decline from the FY 98 level of \$1.7075 million to meet the target figure of \$1.630 in FY 99 and FY 2000. Overseas, our OE requirements increase only modestly despite significant expected inflation. Our FY 2000 requirement is for \$40.728 million, which is less than 3% above our estimated FY 98 amount and less than our requirement for FY 99. Requirements in FY 99 are slightly more at \$41.204 million but again, only a modest 4.5% above FY 98.

II. NEW INDEPENDENT STATES

A. Introduction

ENI requests \$925,000,000 for the FREEDOM Support Act (FSA) account in FY 2000 to continue the development of market democracies in the New Independent States (NIS) of the former Soviet Union. This request represents a continuing evolution in the program, away from traditional technical assistance mechanisms toward deepening U.S.-NIS partnerships and consolidating reforms at the local level.

In FY 1998, the Administration initiated the Partnership for Freedom (PFF), which placed a new emphasis on trade and investment and long-term cooperative activities between NIS countries and the United States. The purpose of the PFF is to support mutually beneficial relationships which will leverage additional private, governmental and community resources for investment in transition and encourage lasting ties between NIS countries and the U.S. In response, the ENI bureau devoted 42% of FY 1998 resources to PFF activities. In FY 1999, this proportion will be increased to over 66%, including funds for local development approaches such as the Regional Investment Initiative (RII), successfully started in Russia during FY 1998. We estimate that a similar percentage of resources will support the objectives of the PFF during FY 2000.

B. U.S. National Interests

The FY 2000 USAID program is an integral part of American Embassy Mission Program Plans (MPP), directly supporting U.S. interests in the region.

National Security: Continued evolution of a U.S.-Russia partnership is a primary goal of U.S. foreign policy, requiring ongoing support for the building of a stable, market-oriented democracy in Russia. Sustained support for economic reform, the rule of law and political pluralism in Ukraine, the Caucasus and Central Asia Republics (CARs) are needed so that these nations can participate in international economic and political arenas. Through the promotion of humanitarian interests, civil society building, economic restructuring and regional cooperation, USAID programs also support U.S. diplomatic efforts in resolving potentially destabilizing problems such as ethnic clashes in the Caucasus (e.g., Nagorno-Karabakh and Abkhazia) and Tajikistan, and energy and water resource concerns in the CARs.

Economic Prosperity: A substantial portion of FREEDOM Support Act assistance is devoted to strengthening the legal and institutional conditions required for broad-based competition, open markets, trade and investment. U.S. Treasury advisors work closely with USAID-funded experts in fiscal reform, while transfers to Commerce support efforts in business development and trade and investment. In addition, USAID programs in Azerbaijan, Turkmenistan, Kazakhstan, Uzbekistan and Georgia are promoting U.S. interests in Caspian oil exploitation and oil transport routes to Western markets.

Democratic Expansion: Significant strides have been taken by many NIS countries in the development of democratic elections, independent media and non-governmental organizations (NGOs) — largely through USAID assistance. While hundreds of NGOs now serve advocacy functions in their respective interests and help open up the political process, their maturation and sustainability over the long-term remain a fundamental challenge, requiring further U.S. assistance. Democratic governance and observance of human rights are advanced through USAID support to national parliaments, judicial systems and local governments. Transfers to USIA for training and exchanges support efforts in democratic and economic transition.

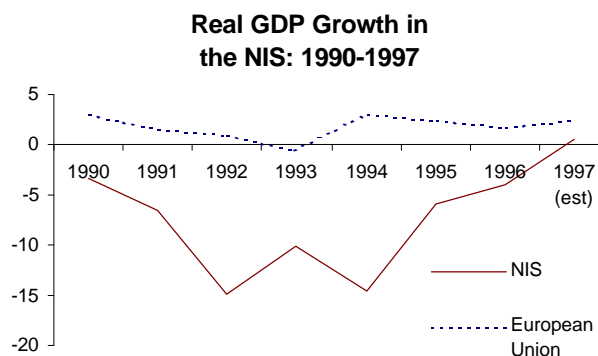
Law Enforcement: Crime and corruption is a major issue in the region, with bilateral implications, as illustrated by U.S. business disputes in Ukraine. USAID programs are working to establish the rule of law and commercial legal frameworks required to improve international investor confidence. Transfers to the Department of State and Justice focus on improved law enforcement skills and technology.

Global Issues: Since 1998, ENI has strengthened its commitment to the Presidential initiative in Global Climate Change. Activities are focusing on Russia, Ukraine, and the Central Asian Republics — three of the priority programs identified by USAID world-wide. There is also a growing infectious disease program for the NIS countries, including tuberculosis and AIDS prevention. Countries receiving family planning assistance have been successful in reducing abortion rates.

C. Progress Against Legislative and Agency Goals: Impact of the Partnership for Freedom

Economic Transition

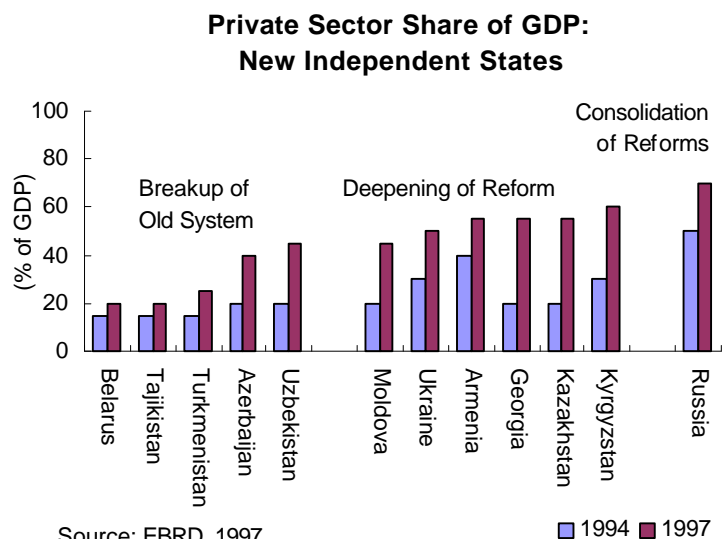
GDP Growth: In 1997, NIS countries continued to make progress against both Agency and Legislative goals. For the first time since the transition began, the NIS region experienced positive growth in GDP. The trend of contracting economies has been reversed, largely due to successes in private sector development and increases in productivity and export growth. Nine out of twelve NIS countries experienced GDP growth higher than 1 percent in 1997, and all twelve NIS countries are expected to meet this USAID target for GDP growth in 1998 — for both years, the results surpass the *USAID Annual Performance Plan* target of two-thirds of NIS countries with greater than 1 percent GDP growth.



Source: EBRD, *Transition Report Update* (April 1998) and IMF, *World Economic Outlook* (October 1997).

Despite the many encouraging signs of progress in the NIS region, recent concern over the stability of the Russian financial market serves as a reminder that these countries are not yet out of the woods. In fact, projected growth in Russia could be negatively affected if the economic situation does not stabilize. The fragile economies and democracies of the NIS will continue to demand our support for several more years, as they continue to struggle with structural reforms in the economy and political environment. As fundamental reforms are put in place, our support increasingly takes the form of partnerships with these countries, both in the private sector (through international trade and investment) and between governments and NGOs (in the form of linkages and exchanges). We have already helped the majority of the NIS countries make dramatic improvements in macroeconomic stability, as demonstrated by the fact that inflation is now under control in nearly every NIS country (from an annual rate of over 3000% in 1993 to just 17% in 1997). USAID will continue to play a vital role in helping to deepen the conditions necessary for sustainable partnerships to grow.

Private Sector Development: The level of private sector development is one of the best indicators of readiness for moving from assistance to partnership. Russia's private sector already accounts for 70 percent of total GDP — nearly equal to the level of private sector development in many European Union countries. Most other countries of the NIS fall somewhere in the middle of the privatization spectrum, with private sector share of GDP ranging between 40 and 60 percent for 1997. The three main laggards — Turkmenistan, Belarus, and Tajikistan — with officially reported private sector shares of the economy at or below 30 percent are still considered to be relatively early in the process of dismantling the old system of state ownership and control over economic resources.



Integration of the NIS into the World Economy: Over the past three years, NIS countries have become increasingly outward looking in their trade relations. Trade with non-NIS partners rose by 16 percent in 1997, while trade with NIS partners increased by only 2 percent last year (the figures for non-NIS and NIS trade in 1996 were 11% and 6% respectively). This dramatic increase in trade reflects increased productive capacity of the NIS economies, a stronger demand for imported goods as local incomes increase, and partial removal of impediments to trade.

Helping to improve the trading environment and diversify the trade portfolio for NIS countries contributes to both US national interests and USAID objectives for the region. International trade and investment help promote broad-based economic growth in the NIS region, and an

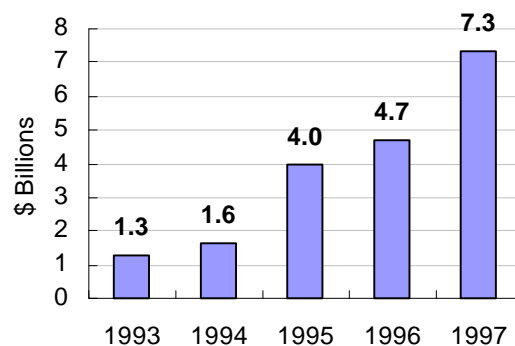
improved trade environment coupled with growing demand in the NIS for western imports will continue to translate into rapidly expanding markets for US exports. Total exports increased for *every* NIS country from 1996 to 1997 — a result notably beyond the Agency FY 1999 target (e.g., positive real export growth in 75 percent of NIS countries) set forth by USAID.

On the international political scene, NIS countries are proving to be increasingly capable of partnerships with the US and other advanced market economies. Russia participated in the recent G-8 summit, and is under consideration (with strong support from the Clinton Administration) for membership in the World Trade Organization (WTO) in 1998. Several other NIS countries — including Armenia, Kazakhstan, and Kyrgyzstan — are also expected to join the WTO in the near future.

Foreign Investment: Another indicator of readiness for sustainable, partnership-based development is foreign direct investment in NIS countries. As the economies become more established and less risky for foreign investors, the amount of direct private investment from US and other sources rises. By helping to improve and stabilize the market environment in these countries, the US Government is ensuring that the private sector will sustain economic growth and development in the NIS, long after the USG has stopped rendering technical assistance to these countries.

Foreign direct investment increased from 1996 to 1997 in eleven out of twelve NIS countries, with 1997 investment for the NIS nearly 56 percent higher than 1996 figures. Growth in foreign investment has been gaining strength for several years, as the economies of the NIS are increasingly perceived as more stable and attractive for investors. Performance in this area in 1997 surpassed the Agency goal, which targeted an increase in foreign investment for 75 percent of the countries in the region.

**Foreign Direct Investment in the
New Independent States: 1992-1997**



Source: EBRD, *Transition Report Update* (04/98).

Democratic Development

Ensuring that the newly established democracies in the New Independent States of the former Soviet Union continue to travel on the path of increasing democratic freedoms is one of the most vital national interests of the US Government. The lack of a democratic tradition differentiates the NIS region from Central and Eastern Europe (CEE), and the relatively slow development of democratic institutions and attitudes in the NIS reflects this difference. While CEE countries are reaching a level of democratic development close to that of Western Europe, most NIS countries still have major room for improvement.

Although progress has been slow in the NIS, there has been little observed political backsliding in most countries for the past few years. According to Freedom House reports, improvements were

registered in Azerbaijan, Georgia, Moldova, Tajikistan, and Uzbekistan, while Armenia and Belarus were the only two countries to experience a worsening in democratic freedoms from 1994 to 1997. On the whole, the New Independent States improved slightly in the area of democracy from 1996 to 1997, meriting a "partly free" (2.9/5.0, with a score of 5.0 denoting "most free") rating from Freedom House.

From 1996 to 1997, improvements in both political rights and civil liberties were noted in a few countries, and no countries in the NIS region were observed to worsen in terms of democratic freedoms. Civil liberties in Azerbaijan improved in 1997, and Georgia earned a higher rating on political rights. Tajikistan improved on both political rights and civil liberties, moving from 1.0 to 1.7 (on a 1.0 to 5.0 scale, with 5.0 representing most free).

Social Sustainability

The extent to which reforms have improved the lives of people is an important concern. Although it is not within USAID's capability to address every social ill that has emerged with the break-up of the former Soviet Union, we do track several social indicators to help assess the sustainability of reforms we are supporting in the economic and democratic spheres.

Experience has taught us that in the early to middle stages of transition, poverty and income inequality are likely to increase sharply. This is due to the nature of existing obsolete institutions and the extent of the transformation necessary to shift from autocratic command systems to private market systems. *Average income* in the NIS still lags significantly behind pretransition levels, with real GDP in 1997 equal to approximately 55 percent of the 1989 level for the region. *Informal economies* are large, and still growing in some NIS countries (estimates average about 40 percent of GDP for 1995). Registered *unemployment* in the NIS is also rising and there is widespread hidden unemployment. About 40 percent of the NIS population lives in *poverty*, although many of the poor are only marginally so. There are exceptions to this trend in the CARs, however, where deep pockets of poverty are suspected in Kyrgyzstan and Tajikistan.

As the proportion of government resources devoted to health care has fallen over the transition period, the *public health* situation in the NIS region has attracted concern, as pre-transition public health infrastructures have collapsed and new health provision structures are still in their early stages. Increasing incidences of infectious diseases such as HIV/AIDS and tuberculosis in Russia are alarming — and the situation is likely worse in many other NIS countries. There has been a dramatic drop in life expectancy in Russia (from 69 years in 1990 to less than 65 years in 1995), and a decrease in life expectancy in Belarus, Ukraine, and Tajikistan. Infant mortality rates have risen in some NIS countries over the past few years, but this phenomenon appears to be a temporary effect of health sector restructuring during the early phase of reforms. Again, the exception to this trend may be in the CARs, where infant mortality remains particularly high for the region, at 35 deaths per 1,000 live births in 1995.

Over the longer term, USAID's substantial support of economic reforms will lead to the creation of jobs, an increase in people's income, and improved access to health services. Over the medium-term, USAID is introducing market-oriented models in housing, health care, and pension plans for countries to consider and replicate. In this regard, U.S.-NIS health partnerships between hospitals, universities and NGOs have been particularly helpful by transferring medical knowledge, technology and innovative delivery systems. In addition, USAID makes selective interventions to address immediate humanitarian and health needs, including a new health initiative in the control of infectious diseases.

Environment

Under central-planning, state enterprises focused on maximizing output with little regard for environmental degradation and energy efficiency. As a result, pollution in the NIS was very high, energy use was nearly the most inefficient in the whole world, and environmental catastrophes (Chornobyl nuclear plant accident, drying up of Aral Sea) took place with alarming frequency. Environmental conditions in the NIS have improved since the transition began, both as a result of decreased production by large industrial plants and the introduction of programs to protect the environment. In many environmental performance indicators, the ENI region appears likely to meet or exceed Agency expectations, although progress may be partially attributable to decreased industrial output during the economic transition. Output of carbon dioxide ("greenhouse gases") has actually fallen by 5.7 percent in the ENI region over the period 1988 to 1995, and countries in the ENI region gained 290 square kilometers of forest area in 1995. In contrast, annual output of greenhouse gases continues to grow and total forest area continues to decrease in all other regions of the world.

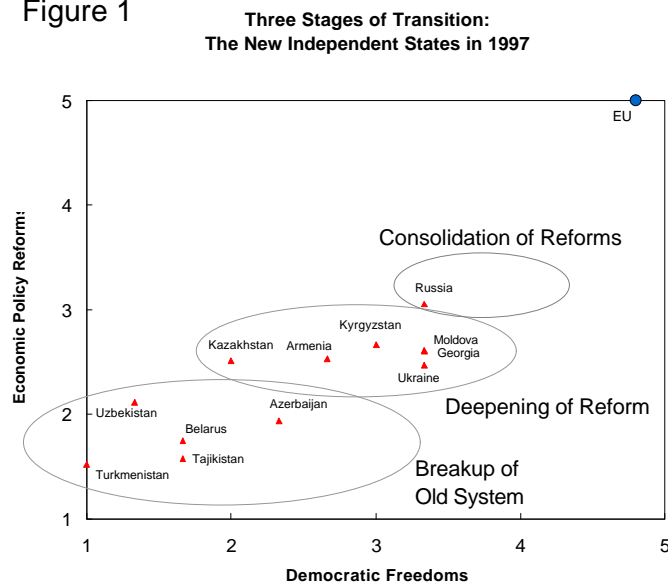
With USAID assistance, National Environmental Action Plans have been completed in Kazakhstan, Kyrgyzstan, and similar environmental action plans are expected to be completed in Armenia, Azerbaijan, Georgia, Russia, and Uzbekistan in FY 1998. Although commitment in the NIS to environmental protection has been considered low to medium over the past few years, the NIS region is expected to exceed Agency goals for introduction of national environmental management strategies and participation in international treaties. Commitment to policies that support environmental protection will become increasingly important in the future, as the NIS economies continue to grow and industrial production accelerates.

D. Status of the Transition and Remaining Challenges

The following graph (Figure 1) compares economic and political transition trends within the region. NIS Countries fall within one of three reform stages:

Breakup of Old System: Countries clustered in the lower left of the graph have been the slowest to reform, tending to hang onto the centralized systems left from the communist era. These are the most authoritarian regimes within the region, although during the past year both Tajikistan and Azerbaijan showed significant improvement in democratic freedoms. With the exception of Belarus, they seek expanded trade relations with the West, but remain reluctant to embrace economic pluralism or democratic values, fearing — correctly — that such actions would destabilize the existing order and jeopardize their position of privilege. Whereas the quality of assistance partnership is weakest in these countries, the transition needs are the greatest. USAID's approach is to maintain a modest presence in these countries, watching after U.S. strategic interests and looking for opportunities to support reformers, especially in the NGO and private sectors. As circumstances require, USAID also responds with humanitarian assistance, as has been the case in Tajikistan or with victims of the Nagorno-Karabakh conflict in Azerbaijan. About 16% of FSA resources are proposed for countries in this category in FY 2000.

Figure 1



Economic policy reform ratings are from EBRD, *Transition Report 1997* (November 1997), and assess reforms through August 1997. Democracy ratings reflect freedoms through December 1997, and are from Freedom House, *Freedom in the World: 1997-1998* (May 1998). Ratings are based on 1 to 5 scale, with 5 representing most advanced.

Deepening of Reform: The six countries populating the middle of the graph have taken significant strides in their reform process, but continue to confront difficult obstacles to fully making the transition to market democracies. ENI allocates a large proportion of its resources (about 59% in FY 2000) to these countries, believing that their transition needs are substantial and USAID's ability to affect change is reasonably good.

The nature and pace of reform differs from country to country. Ukraine and Armenia benefit from strong interest group support within the United States. They enjoy large foreign assistance earmarks, although their transition performance has been uneven. Because of wavering political will in both these countries, USAID's challenge is to find effective ways to apply large resources to transition objectives. The regional investment initiative in Russia may prove to be a useful model for Ukraine. However, Armenia's lack of economic development infrastructure suggests it may not yet be ready for this type of assistance approach.

While Kazakhstan demonstrated an early commitment to economic restructuring, its record in democratic reform has been more disappointing. With power concentrated in the presidency, the judiciary is not yet independent, freedom of assembly is sometimes restricted, and the media

practices self-censorship. USAID's challenge is to support the deepening of reforms in the economic sphere, while promoting a change in the balance of power within the government through strengthening democratic institutions in the judiciary and legislature.

Moldova, Georgia and Kyrgyzstan have each been considered a model of reform in their respective sub-regions. Compared with their neighbors, they are small countries, with limited resources. Due to these circumstances, they have embraced the reform path hoping to forge strong ties with the West. However, their limited economic potential over the long-term makes them less attractive to foreign investors and less important in terms of U.S. foreign policy interests. This appears to be changing for Georgia, given its possible role as a terminus for oil pipelines and exports from Central Asia. Moldova and Kyrgyzstan have not yet developed similar economic linkages to the West. USAID's challenge is to help each of these countries to form lasting economic and political ties with developed countries, including transition countries in Central and Eastern Europe. Given the severity of social conditions in Kyrgyzstan, USAID will closely track key indicators to determine whether more traditional development assistance interventions are needed.

Consolidation of Reform: In the third stage of transition, USAID is concerned that the benefits of reform efforts reach beyond the national level and are reflected in the lives of people. Russia is the largest and most progressive NIS country, and the only one that has reached the third stage of the transition process. Since FY 1998, USAID has supported an integrative approach to promoting foreign investment at the regional level in Russia. Initial efforts of this Regional Investment Initiative (RII) have been in the Novgorod Oblast. Based on these successes, activities will commence in the Russian Far East (RFE) and Samara. At the same time, ENI is devoting an increasing share of budget resources toward U.S.-Russian partnership mechanisms in democracy, health, and environment.

The stakes in U.S. assistance to Russia continue to be high given overriding U.S. foreign policy and geo-political interests. The United States wants to work with Russia as partners in resolving transnational issues (e.g., drugs, arms trade and control, Global Climate Change, and regional peace initiatives such as in the Balkans, Middle East, Nagorno Karabakh in Azerbaijan, etc.). USAID's remaining challenge in Russia is threefold. First, to address technical weaknesses in the reform process (e.g., fiscal reform and its relationship to sound financial markets). Second, to duplicate successful RII approaches in other receptive regions. Third, to support U.S.-Russian bilateral relations in concrete and meaningful ways, as has been done successfully under the Gore-Chernomyrdin Commission (now, Gore-Kiriyenko).

E. Significant Initiatives

Global Climate Change: USAID's approach to mitigating the NIS-based threat of global climate change (GCC) focuses heavily on energy efficiency and direct emissions reduction. Whereas Russia, Ukraine and the CARs are priority programs for GCC, the bureau is also addressing

climate change issues to a lesser extent in other NIS countries. In FY 2000, the bureau currently anticipates \$48 million of the FSA budget will address GCC concerns.

Building on past successes in climate change programs, present and future assistance is being structured to help NIS countries meet emissions reduction obligations under the United Nations' Framework Convention on Climate Change. USAID programs in policy development, power sector efficiency, sustainable forestry, and energy/environmental partnerships are already achieving results. For example, USAID's reforestation program in Russia is helping to reinvigorate a critical buffer to the effects of global climate change. The program has increased the production of high quality seedlings to over 1.2 million in 1997, compared to the 6,500 seedlings produced before the initiation of assistance. With the support of related policy changes, these efforts will become self-financing. By 2005, we anticipate 10 million trees per year will be produced with Russian and private resources.

Health: Recognizing the importance of U.S. assistance reaching individuals in immediate and demonstrable ways, the PFF started to promote the control of infectious diseases last year. While the diphtheria epidemic of 1991-95 and humanitarian issues more generally were a focus of earlier efforts in health, more recently acute respiratory infections (ARI), control of diarrheal diseases, tuberculosis (TB) and HIV/AIDS as well as capacity building have become the thrust of USAID-funded activities. In response to a Congressional earmark in FY 1998, new HIV/STD and TB initiatives are being funded in Central Asia, Caucasus, Russia and Ukraine. This effort is complemented by continuing efforts in women's health and family planning. As appropriate, health partnerships are serving as an important mechanism for reforming and improving delivery of services to these areas. We anticipate about \$ 78 million of the FY 2000 request will be devoted to improving health in the NIS.

F. NIS Regional Programs

ENI programs are funded regionally when country-specific activities require a multi-country approach to enhance results and maximize the long-term benefits of assistance. Regional programs are managed by or subject to the management oversight of an ENI/W office or team. The types of activities that qualify for regional funding are: (i) programs whose success depends upon concurrent action and/or cooperation by two or more countries; (ii) workshops, information networks, and institutional support for cross-border sharing of transition experience; (iii) assessment/design mechanisms whose flexibility and rapid response capability would be impaired if budgeted on a country-specific basis; and (iv), programs intended to extend U.S.-country relationships and reinforce sustainability beyond closure of USAID posts.

In FY 2000, ENI is requesting approximately \$4.37 million to support regional NIS efforts in economic restructuring, including energy and environment. In a co-financing arrangement with OECD, the bureau will initiate a new activity to harmonize **accounting reform and auditing practices** across countries so as to encourage adoption of internationally-accepted standards and facilitate capital flows beyond borders. The bureau will also continue regional arrangements with

the **Securities and Exchange Commission** and **National Securities Clearing Corporation** to tap high-level talent in response to specialized country needs. The **Association of NIS Banker Training Institutes** activity will develop high priority, computer-based training courses (e.g., commercial bank risk management; international accounting standards) for distribution to past and present USAID-funded banker training centers and participating commercial banks. Semi-annual regional seminars will bring together U.S. and other Western bank regulatory practitioners with their counterparts in the NIS and CEE to promote **standardization of banking laws/regulations** and help recipient countries meet financial sector directives for entry into the EU.

Because of increased electricity trade over the medium- to long term among the NIS, CEE and Western European countries, ENI initiated support last year for a **sustainable regional energy regulatory network**. In 1997, 50 regulators from 16 countries came together and defined a preliminary set of regional activities. A smaller working group followed-up in April and a technical working group met in June on electricity licenses. Based on these successful steps, ENI will continue to support the Regional Association of Energy Regulatory Commissions during FY 2000. The **Environmental Partnership Program** (EPP), beginning in FY 1998 for a five year period, will promote solutions to environmental problems appropriate to market democracies. The program will establish professional and financial linkages between U.S. and NIS businesses, local governments and trade and professional associations, including technology links between the Global Technology Network in the U.S. and the Department of Commerce efforts in the field. EPP will also be an important vehicle for advancing the Agency's Global Climate Change initiative.

ENI is also requesting approximately \$4.63 million for regional initiatives in democracy, social sustainability and cross-cutting areas. ENI will maintain a rapid response capability for **political processes strengthening** to address unforeseen election opportunities. Under the rule of law rubric, the bureau will continue its support for **judicial capacity building and networking**, and expand the focus of activities to include assistance for accession of NIS countries to regional and international bodies and treaties (i.e., GATT, European Free Trade Association, European Convention on Human Rights, etc.). The **local government networking program** has been highly successful in facilitating exchange of information and best practices among officials, community leaders and experts through conferences, workshops and a local government website. This support will continue in FY 2000 and include collaborative work with other donors such as the World Bank and the Council of Europe in fostering comparative analyses and dissemination of lessons learned in local government strengthening.

As in past years, funding is requested for **regional health sector activities, including medical partnerships**. These funds are used to make ENI's country-specific investments in health more cost effective by sharing information across borders in areas critical to improving sector performance: infectious disease management; market-oriented health care delivery; quality of clinical services; and women's reproductive health. Results to date have exceeded expectations and include: garnering support and financial commitments for health from other donors and Ministries of health; expanding the number of pilot sites for demonstrating innovative health

practices; raising standards of performance in critical areas of health sector operations; and increasing independent networking among counterparts across the region.

Cross-cutting regional programs include funds for addressing Y2K problems for program-funded information technology in ENI/W, core participant training processing/monitoring tasks, performance measurement and evaluation work, and disseminating program lessons across the region.

G. FREEDOM Resource Request

As in FY 1999, we are again requesting \$925 million for the FSA account for FY 2000. This request will enable USAID to support the PFF at the level necessary to achieve its objectives in Russia and across the NIS; maintain levels in the Caucasus, W/NIS, and, to the extent possible, in the CARs; proceed with the Administration's Trans-Caspian energy initiative; increase attention to infectious diseases; and continue to address Global Climate Change in Russia, Ukraine and Central Asia. A common theme in most country programs will be to expand the impact of transition beyond capital cities, complementing efforts in institutional and policy change at the national level with capacity-building at the grassroots, local and regional levels. Our request level for regional resources is also similar to last year and represents about 6% of the FY 2000 budget request.

Economic Restructuring and Growth

Economic restructuring strategic objectives continue to capture a major portion of resources (about 30% of the FSA request), and are reinforced by activities managed by other agencies which are covered under special initiatives. For the less reform-minded countries, these resources will generally be used to promote small-scale privatization, small and medium-sized business development, and liberalization of the trade regime. For those countries in the middle of their transition, resources will continue to support development and strengthening of the fundamental systems needed for market economies to operate. For instance, comprehensive market reform in Armenia and Georgia are multi-year efforts, integrating activities in accounting reform, capital market development, fiscal reform, land privatization, banking supervision, and as required, strategic privatization work. In addition, most NIS countries will benefit in FY 2000 from PFF mechanisms which emphasize economic growth and investment, such as partnerships in environment, energy, and in some cases, agribusiness. As technical assistance begins to wind down in the most progressive country, Russia, USAID will provide selective support to alleviate barriers to transition (e.g., tax reform) and to replicate systems at the regional level (e.g., strengthen regional security and exchange commissions). Resources under this rubric will also support expansion of the Regional Investment Initiative in Russia and possible replication in other progressive NIS countries.

Democracy and Governance

About 11 percent of the FSA FY 2000 request is devoted to democracy and governance objectives, recognizing that ultimately, economic and democratic reform go hand in hand. Market economies cannot fully operate without political freedom and civil liberties firmly in place. The authoritarian tendencies of many of the NIS governments need to be balanced with increased citizen advocacy, demand for government accountability, and stronger institutions at the regional and local levels. FY 2000 resources will continue to support free and fair election processes, growth of independent media, NGO development, the rule of law, and local government strengthening. USAID will also continue to emphasize crime and corruption concerns, integrating judicial systems strengthening with economic restructuring objectives, such as commercial law development.

Social Stabilization

FSA resources proposed for social stabilization are just under 10 percent of the FY 2000 request. Of this amount, about 22 percent is targeted to humanitarian needs due to unresolved regional conflicts in Nagorno Karabakh and Abkhazia. However, this allocation also reflects a shift in country program emphases begun with the FY 1999 request for Georgia and Armenia, where USAID is phasing down humanitarian assistance and devoting a greater amount of resources to economic and democratic reform. Under this rubric, infectious disease control is being addressed in Russia and Ukraine. Several country programs are also developing alternative, market-oriented models for health care delivery and pension plans.

Cross-Cutting/Special Initiatives

The FY 2000 budget for cross-cutting and special initiatives constitutes about 37 percent of FSA resources. This percentage is high because it includes most transfers to other US agencies. Cross-cutting activities include efforts which contribute to more than one strategic objective, such as the Eurasia Foundation which provides small grants to grass-roots organizations under both the economic restructuring and democracy rubrics. Training programs also support strategic objectives across the portfolio. Special initiatives generally include activities managed by other US agencies. Some of these -- such as US Departments of Treasury, Commerce, and Energy (Nuclear Safety) -- directly support ENI strategic objectives. Other activities -- such as Peace Corps, US Information Agency, and the State Department Science Centers -- are funded to serve broader US interests or address special circumstances.

Field Support

The FY 2000 FSA request for Global Bureau support totals over \$36 million. Of this total, more than \$27.4 is targeted for participant training activities, approximately \$6.8 million for health and family planning, and \$2.1 million for energy and other economic restructuring needs.

Donor Coordination

Within the context of the Transatlantic Initiative, USAID and other U.S. agencies have coordinated with the World Bank, the European Bank for Reconstruction and Development (EBRD), and the European Union to leverage hundreds of millions of dollars, *beyond FSA contributions*, for the region. USAID also works with the Asian Development Bank regarding programs in the Central Asia Republics.

For example, the EBRD Russia Small Business Fund provides loans to small and micro-enterprises through selected Russian commercial banks. USAID's contribution, totalling \$30 million, supports targeted technical assistance to the Russian banks implementing the program. USAID's assistance has been pivotal to leveraging a small business fund of \$300 million for Russia over a ten year period. In Ukraine, USAID-funded organizational assessments of the Ministry of Finance and Ministry of Economy have contributed to the planning of the World Bank's \$200 million Public Administration Reform Structural Adjustment Loan. USAID's close coordination with the World Bank has also expanded support for the health sector in Kyrgyzstan, where a loan has been signed for \$25 million to expand USAID's health reform model to additional oblasts. A similar loan totalling \$40 million is being negotiated with the Government of Uzbekistan.

Generally, USAID technical assistance is tied closely to the World Bank's structural adjustment loans and the conditionality in the IMF's stand-by agreements. In Ukraine, for example, USAID and U.S. Treasury advisors have worked closely with IMF and World Bank resident advisors in identifying and helping the Government meet a broad range of tax and budget reform conditions proposed in the World Bank's \$200 million Public Resource Management Structural Adjustment Loan. In Kazakhstan, USAID advisors ensured that conditionality concerning international accounting standards was added to a World Bank loan and as a result, the Government of Kazakhstan adopted the standards. In a related example, USAID spearheaded the adoption of international accounting standards in Kyrgyzstan through the inclusion of appropriate conditionality in an Asia Development Bank loan.

III. CENTRAL AND EASTERN EUROPE

A. Introduction

ENI requests \$382 million for the Support for East European Democracy (SEED) account for FY 2000 to continue the development of market democracies in Central and Eastern Europe (CEE). In addition, ENI is requesting \$34.6 million of Economic Support Funds for Cyprus and Ireland, and \$4 million in Development Assistance Funds for Turkey.

Impressive gains continue to be made in the region. Five Northern Tier CEE countries have recently been invited to participate in the next round of negotiations towards EU membership. For several Southern Tier CEE countries, 1997 witnessed evidence of renewed reform efforts. In Bosnia, 1997 represented the second year of calm, and further progress in the implementation of the Dayton Accords.

This request represents, accordingly, a continued geographic shift in the SEED program. By FY 2000, seven Northern Tier CEE countries will have graduated from the program. Hence, the lion's share of the FY 2000 program funds will be targeted to achieving two inter-related objectives in the Southern Tier CEE countries. One is moving the Southern Tier CEE countries of Romania, Bulgaria, Macedonia, and Croatia, along the transition path and towards eventual graduation from the SEED program. The second addresses critical foreign policy priorities of maintaining stability and facilitating reconstruction and development in Bosnia-Herzegovina and the Former Republic of Yugoslavia (FRY) consisting of Serbia and Montenegro. Albania, at the same time a transition and a developing country, is unique in the region. It will be treated as a separate case.

B. U.S. National Interest

The FY 2000 USAID program, as reflected in the American Embassy Mission Program Plans (MPP), supports U.S. interests in the region in several ways.

National Security: The end of the Cold War has put our relationship with this region on a basis of cooperation instead of rivalry, as CEE countries work with the U.S. and its allies to build new security arrangements to promote peace and prosperity. The decision to enlarge the North Atlantic Treaty Organization (NATO) to include Poland, Hungary and the Czech Republic represents tangible evidence of significant progress. In Bosnia, the U.S. Government in concert with NATO allies and the international donor community is committed to stabilizing the post-war situation, providing a foundation for economic revitalization and assisting with the establishment of effective political and constitutional institutions.

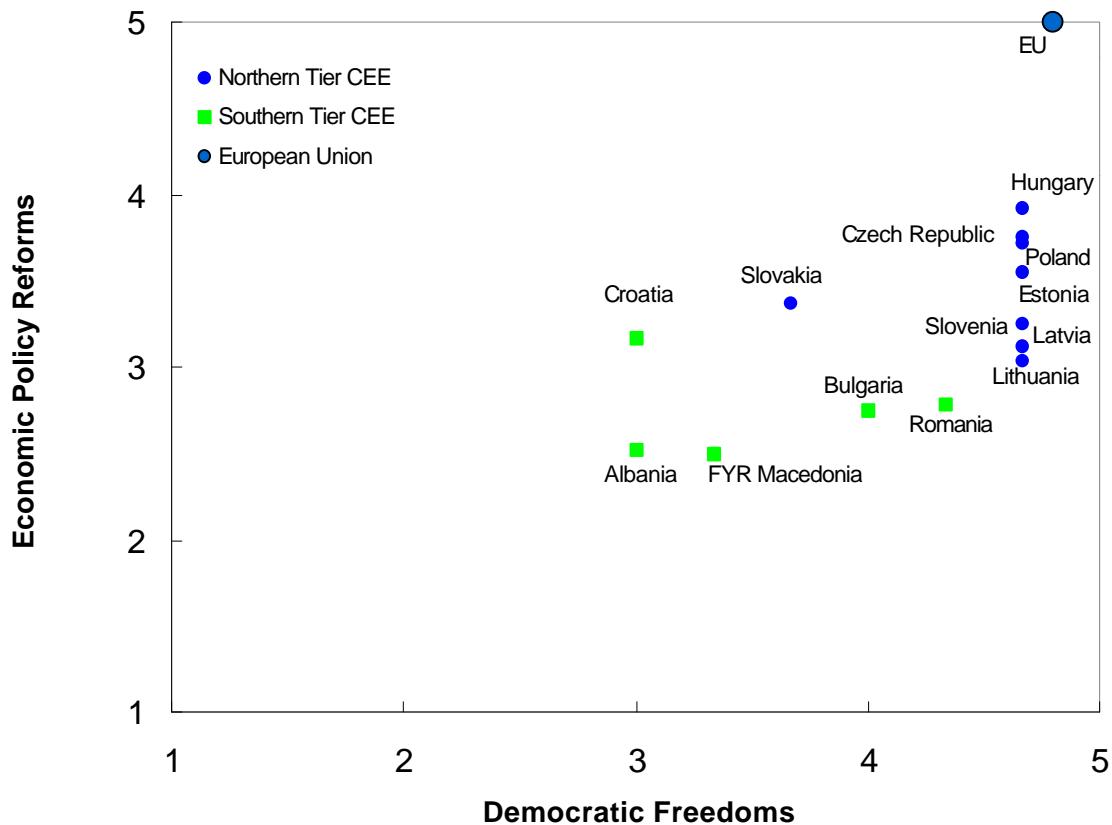
Economic Prosperity: A substantial portion of U.S. assistance to the region is devoted to strengthening the environment for economic competition, open markets, trade and investment. U.S. merchandise exports to the region have nearly tripled in the last decade and have the

potential to multiply several-fold in the coming years, translating into well-paying, export-related jobs. Trade in the region has been growing at a robust 15% per year (18% in the Northern Tier). Increasingly, this trade is with the West. The proportion of CEE trade with advanced economies has increased from 40% of exports in 1989 to 70% in 1995.

Democratic Expansion: Democracy has taken root in the CEE. Hundreds of active nongovernmental organizations (NGOs) now serve advocacy functions and help open up the political process. Local governments strengthened by USAID programs have effectively lobbied central governments for a greater share of resources and decision-making power. Free and fair elections are routine in most of the region. Even in the Southern Tier countries which have lagged behind their northern neighbors in democratic reform, Bulgaria and Romania have held free and fair elections.

Global Issues: SEED will support the Presidential initiative in Global Climate Change. This initiative focuses on decreasing the rate of growth in net greenhouse gas emissions by reducing emissions from greenhouse gas sources and maintaining or increasing greenhouse gas sinks such as forests and other vegetation, which consume carbon dioxide and help to reduce undesirably high levels of carbon dioxide in the atmosphere. The Initiative also supports developing and transition country participation in the United Nations' Framework Convention on Climate Change (FCCC), and focuses on decreasing the vulnerability of these countries to the threats posed by climate change. Poland is considered a key country under this initiative for the CEE region.

Figure 1: Economic Policy Reforms and Democratic Freedoms in Central & Eastern Europe, 1997



Economic policy reform ratings are from EBRD, *Transition Report 1997* (November 1997), and assess reforms through August 1997. Democracy ratings reflect freedoms through December 1997, and are from Freedom House, *Freedom in the World: 1997-1998* (May 1998). Ratings are based on 1 to 5 scale, with 5 representing most advanced.

C. Progress Against Legislative and Agency Goals

The Support for East European Democracy (SEED) Act of 1989 dictates that country specific assistance strategies for the region build on common, region-wide strategic goals of economic restructuring, democratic transition and social sustainability. SEED funded programs in general concentrate on the following areas:

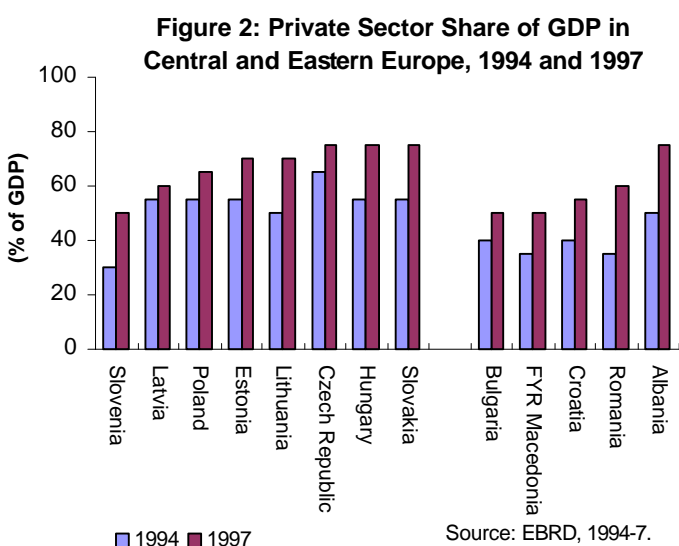
- the development of a market economy and strong private sector;
- the development and strengthening of institutions necessary for sustainable democracy; and
- the improvement of the basic quality of life in selected areas.

In addition to the traditional activities carried out by the SEED Program, the SEED appropriation also provides funding for economic reconstruction and other activities in Bosnia that fulfill the 1995 General Framework Agreement for Peace in Bosnia and Herzegovina and its supporting annexes, commonly known as the Dayton Accords. The legislative "150 account" performance goal in this regard is that there be "significant progress" toward implementing the Dayton Accords in Bosnia.

USAID has also established a number of agency performance goals by which to measure progress in its programs. These goals are of two types: (1) targets - explicit levels of results to be achieved within a ten-year time frame; or (2) trends - desired directional changes sought. The primary goals which are applicable to ENI's work in CEE are: (i) average annual growth rates in real per capita income above 1% achieved; (ii) openness and greater reliance in private markets increased; (iii) level of freedom and participation improved; (iv) host government commitment to sound national and international environmental programs; (v) rate of growth of net emissions of greenhouse gases slowed; (vi) conditions for social and economic development improved in conflict, post-conflict and rapid transition countries; and (vii) political rights and civil liberties in post-conflict situations increased. As highlighted below, most of these agency performance goals are being met or exceeded in CEE.

In general, overall progress against legislative and agency goals has been impressive in CEE, though clearly most tangible in the Northern Tier countries. Below, this progress is assessed in terms of the economic transition, democratic reforms, and social sustainability. Figure 1 highlights overall progress in economic and democratic reforms in the region. Progress towards implementing the Dayton Accords is addressed separately.

Economic transition: Economic reforms continued to move ahead in 1997 throughout the Northern Tier countries. With the liberalization of domestic markets and prices, trade and foreign exchange reforms, and privatization largely completed, efforts focused on consolidating financial



sector reforms and establishing better corporate governance among the newly privatized firms as well as the new starts.

The progress in economic reforms in the Northern Tier countries is reflected in the impressive advance of the private sector and in macroeconomic performance. thanks to USAID assistance in privatization, almost 70% of economic activity in these countries is now in private hands (see figure 2). Economic growth continues at a robust clip, with levels reaching over 4% in 1997 and well above the Agency goal of 1% (see figure 3). Inflation continues to drop in the

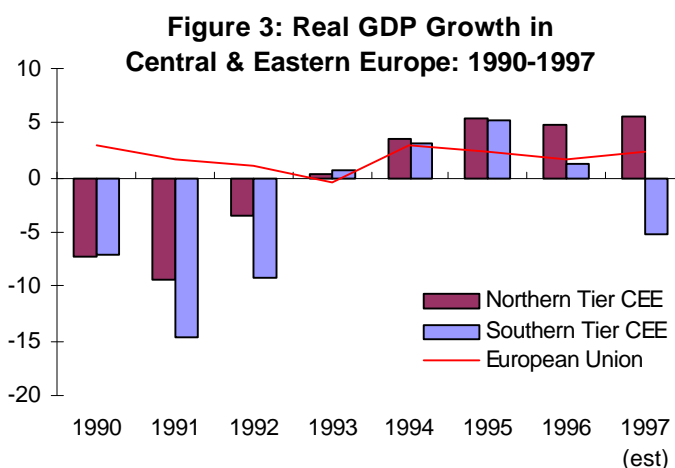
Northern Tier, and in 1997 was 13% on average. With liberalized trade regimes, export growth has been close to 20% per annum in recent years. This coincides with substantial re-orientation of trade toward the West and growing foreign direct investment from OECD countries. The Agency goal of increased openness and greater reliance on private markets has clearly been met in these countries.

The countries of the Southern Tier have made less impressive progress. These countries were slow to reform. Resultant economic crises led to the election of more reform-oriented governments (in November 1996 in Romania, April 1997 in Bulgaria, and July 1997 in Albania). Progress in economic reform has ensued, but considerable economic restructuring remains to be done. These countries have not yet been able to sustain the reform process and hence deepen it to the extent that has happened in the Northern Tier. This means that privatization is incomplete, commercial law frameworks have yet to be fully implemented, and, more broadly, much economic institution building remains to be done. A critical aspect to this - and in line with historical comparative advantages - is developing private ownership in agriculture and agribusiness. As the sector continues to be a major thrust of the USAID program in Romania, Bulgaria, Macedonia, and Albania. Support ranges from facilitating land reform (privatization and restructuring), to increasing credit access, and nurturing agribusiness associations to promote and sustain the gains. USAID is working closely with these new governments, and although much more needs to be done, the prospects for greater progress is good.

The progress in economic reform in the Southern Tier has not yet translated into good macroeconomic performance. In fact, renewed efforts to restructure have likely contributed to a temporary slowdown in economic activity. Strong albeit unsustainable economic growth in 1994-1995 gave way to economic

contraction for the sub-region as a whole in 1997. This is illustrated in the graphic depiction of the growth in gross domestic product region-wide shown in figure 3. Furthermore, inflation increased from 24% in 1995 to almost 100% in 1996 and close to 200% in 1997. Nevertheless, if recent economic reform efforts can be sustained good macroeconomic performance will likely result, and this may begin to be reflected in 1998 figures.

Democratization: Progress in democratic reforms in the Northern Tier countries since communism's collapse has been nothing less than extraordinary. By Freedom House measures, seven countries of the sub-region now have democratic freedoms on par with Western Europe. Latvia, which experienced an increase in political rights in 1997, is the most recent member of this group. Of the Northern Tier countries, only Slovakia lags in this regard. Furthermore, again with



Source: EBRD, 04/98; IMF, 10/97

the exception of Slovakia, there has been no temporary backsliding in democratization in the Northern Tier since the transition began. While the Agency goal of greater freedom and citizen participation is being met, democracy building in the region is not complete. Much of the needs center on nurturing a nascent civil society and promoting a sustainable NGO sector. This is currently a focus throughout the Northern Tier USAID country programs as a means to secure the achievements made in the establishment of a vibrant civil society and NGO strengthening will be a major "post-presence" (post-graduation) programmatic focus in CEE.

Progress in democratization in the Southern Tier, while evident, does not approach Northern Tier standards. By Freedom House measures, Croatia and Albania lag the most in democratic reforms and, in fact, trail several New Independent States in this regard. Romania has made the most impressive gains in the recent past with an increase in political rights in 1996 and in civil liberties in 1997. Since 1995, some backsliding has occurred in Albania (in political rights in 1996), and Bulgaria (civil liberties in 1996). Overall, however, the trend has been towards greater freedom and citizen participation in the region, thus meeting the Agency's goal in democracy.

Most of the lag in progress in democratic reforms throughout the Southern Tier in recent years, has been in local governance and public administration, rule of law, and independent media. However, the election of reform-minded governments has brought in its wake new receptivity on the part of such governments to address these needs. USAID programs have adjusted accordingly. New rule of law programs are being implemented in Bulgaria and Albania (focusing in part on anti-corruption programs); and local governance efforts in Bulgaria and Romania are becoming more successful. These local governance programs have facilitated the development of administrative and financial capacities necessary to sustain transition progress at the local level.

Social Sustainability: Much of the deterioration in the social conditions in the initial stages of reform in the Northern Tier has subsided and some negative trends have recently been reversed. Average (official) income for the sub-region overall is virtually back to pre-transition level. The informal economies remain large, ranging perhaps from 15-20% of GDP, but seem to be now declining. This bodes well for continued robust performances of the formal private sectors and may suggest a declining role and need for the informal sector in its capacity as an unofficial safety net. Unemployment is high (11%), though no higher than that experienced in the EU. Poverty has increased from an insignificant level prior to the transition to approximately 11%. The Northern Tier infant mortality rate is on par with the OECD average of 12 deaths per 1,000 live births, down from 16 deaths in 1989. Secondary school enrollment has been increasing in the Northern Tier since 1990 and at 87% enrollment, is close to EU norms of 90%.

The SEED program has been envisioned, since its inception, to be short-term in nature and one that places highest priority on helping to move the countries far enough along the economic and democratic reform path so that they can then complete the transition without U.S. assistance. In this context, direct U.S. government assistance towards social sustainability has typically been modest, particularly in the Northern Tier countries where it is clear that social conditions do not endanger the implementation of economic and democratic reforms. However, social conditions in the Southern Tier provide some basis for concern. Average income still lags behind pre-transition

levels, close to 80% of the 1989 level for the subregion as a whole. Informal economies are large and likely still growing. Unemployment is high, though no higher than levels recorded in the Northern Tier countries and in the EU. These levels likely will increase for a period of time as further restructuring occurs. Perhaps as many as one in three persons live in poverty. Infant mortality rates may be still increasing; at 21 deaths per 1,000 live births on average, these rates are significantly higher than those in the Northern Tier (at 12 deaths) and comparable to NIS rates (at 20 deaths).

These social trends in the Southern Tier need to be closely watched. U.S. assistance is targeted, in concert with the other donors, to help mitigate the high infant and maternal mortality rates in the region, in Romania, Albania, and Bulgaria in particular. The most effective means to reverse these adverse social trends, as has happened in the Northern Tier, is to focus on efforts which encourage governments and societies to continue to implement the economic reforms as quickly as is feasible. In this manner, through broad-based economic growth and employment generation, those who have so far been largely excluded from the gains of the transition will be able to participate in the sharing of such gains. Examples of USAID's work in the region include:

- the establishment of a major model child welfare program with U.S. PVOs in 3 large counties in Romania. This program will help shape the program of other donors; and

- assistance with health planning and finance options to introduce fee-for-service and health-insurance alternatives for health care finance in Albania. As part of its hospital partnerships program, USAID/Albania also trains health care professionals to practice preventative medicine, family planning, and helps to improve the quality of hospital services and health administration.

Dayton Accords and the FRY¹: The 1995 General Framework Agreement for Peace in Bosnia and Herzegovina and its supporting annexes (the Dayton Accords) provide the structure and objectives for an international operation aimed at promoting peace and stability in Bosnia. The Bosnia program's objectives are to create conditions that allow Bosnia's political leaders to: 1) provide security for the people of Bosnia; 2) create a unified, democratic Bosnia that respects the rule of law and internationally recognized human rights, including cooperating with the War Crimes Tribunal in arresting and bringing those charged with war crimes to trial; 3) rebuild the economy; and 4) ensure the right of people to return to their prewar homes. This program has received significant political, military, and financial support from the United States government through the 150 account. USAID and other USG agencies have contributed to the promotion of

¹The Dayton Accords effect the recently established Federation of Bosnia and Hezegovina. Republika Srpska (RS) is an autonomous region within the Federation of Bosnia and Herzegovina. As previously noted, the FRY refers to the Federal Republic of Yugoslavia. It is comprised of Serbia, including among others the autonomous province of Kosovo, and the republic of Montenegro.

regional stability, police and judicial reform, macroeconomic reform, democratic reform, economic reconstruction, refugee returns, and the prosecution of war criminals.

Nineteen ninety-seven marked Bosnia's second peaceful year following three and a half years of war. The results of peace continue to emerge; key municipal services are being restored, businesses restarted, jobs created. Because of its strong commitment to implementation of the Dayton Accords, the Federation entity has seen much greater reconstruction assistance and consequently much greater economic improvements than the Republika Srpska (RS). In 1997, the Federation economy continued to climb back toward its pre-war levels with a GDP growth of 37 percent. According to the World Bank, the average monthly wage in the Federation has risen to approximately \$155 (\$35 per week) in 1997. In comparison, the average monthly wage in the RS has been estimated at approximately \$60 (\$14 per week).

Significant progress has been achieved in the USAID program in Bosnia. USAID programs pushed judicial reform forward through the establishment of cantonal courts, the creation of a Federation-wide Judges' Association, and the revision of the Federation's Procedural and Substantive Criminal Codes. Economic reforms adopted include the passage of four Federation privatization laws, the establishment of the Federation Banking Agency, and the creation of a joint USAID-European Union (EU) customs modernization program. USAID media seminars, with their emphasis on the creation of an independent weekly news magazine program and the implementation of marketing and production skills, helped to bolster democratic reforms. The establishment of many new businesses and the repair of rail lines, power transmissions, and water systems contributed to economic reconstruction and refugee returns. The activities carried out by USAID grantee ABA/CEELI in conjunction with the War Crimes Tribunal, in which American lawyers screen the cases of persons suspected of war crimes, helped curb false charges. Police training activities, administered through INL, held in 1998 contributed greatly to improving regional stability in Bosnia-Herzegovina.

In the FRY, war, sanctions, and poor economic policies have significantly hampered economic progress. Today, income levels are roughly one-half the 1989 level, even though economic growth has been occurring since 1993. This level is more akin to NIS status where the 1997 levels are approximately 55% of the 1989 levels. In the rest of CEE, the ratio is closer to 90%. In Serbia-Montenegro, unsustainably high current account and budget deficits exist. There has been, however, good progress in reducing inflation. In 1997, it was close to 12%, achieved through adherence to a restrictive monetary policy which unfortunately has adversely affected banks.

The USAID program in the FRY is very new. The USAID presence was established less than a year ago. However, in addition to the work already being done in compliance with the Dayton Accords, USAID will expand support for the nascent democracy movement in Serbia and Montenegro as part of U.S. interests in regional stability. It is anticipated that targeted assistance in the democracy area will strengthen those forces which support ethnic reconciliation and democratic change, thus increasing pressure for fundamental political change in Serbia.

Special mention must be made of Kosovo. Kosovo is a portion of Serbia with an estimated population of 2.2 million, 95% of whom are ethnic Albanian, and Muslim. This region has the greatest poverty and lowest quality of life in the FRY. Kosovo is by all measures equivalent to a third world developing area, complete with serious social problems in the areas of health, education, food, shelter, and environment, as well as contentious human rights issues. Kosovo could be expected to be in a development mode well after economic transition is underway elsewhere in the FRY.

Kosovo has drawn world attention as a region rife with ethnic conflict and political suppression. Besieged with abuses of power that have led to serious human rights infractions, some of the political and student leaders have demanded separation from Serbia, a position not endorsed by the international community. Extremism and intransigence have led to increased militancy on both sides. Open conflict in Kosovo has led to clear abuses of human rights and to calls for renewed international sanctions against Serbia. USAID has provided substantial humanitarian assistance, primarily through BHR. Other activities seek to bring people and communities together, through education and health efforts, assisting the media and moderate leaders in conflict resolution.

In contrast to Kosovo, the Republic of Montenegro has a relatively clean human rights record. Although small in size, it is a vital strategic state for the FRY because it has the FRY's only direct access to the sea. Montenegro successfully fought off an attempt by Milosevic's FRY government to change the federal constitution, which would have boosted the powers of the federal presidency at the expense of Montenegro. It is anticipated however that these challenges for power will continue. Politically, Montenegro was one of the few bright spots in the FRY during 1997.

However, standing up to the FRY leadership has compounded the existing serious economic and social problems of the republic, already extremely impoverished by long international isolation. Montenegro's economic lifeline is based on trade, transport and tourism. Internal blockades of trade imposed by Belgrade have effectively closed the access to domestic and neighboring markets, thus shutting down many private businesses which were just emerging since the lifting of the earlier embargo. Under such constraints and with only modest help from the British Know-How Fund, Montenegro embarked on its own privatization and capital market development program and has requested assistance in areas such as tax administration, finance reform, bank restructuring and updating accounts to further reform the economy. USAID will respond to such needs to support the more reformist forces in Montenegro, in the belief that a strengthened democratic regime there, which is able to bring economic progress to its people, will also serve as a catalyst for change in the Milosevic regime itself.

D. Program Challenges

Northern Tier: Sustaining Transition and Strengthening Partnerships. By the end of FY 2000, it is expected that the resident bilateral programs for all eight Northern Tier countries will have ended. Three countries have already graduated--Estonia in FY 1996 and the Czech Republic and

Slovenia in FY 1997. Hungary and Latvia are expected to graduate in FY 1999, and Lithuania and Poland in FY 2000. The Slovakia assistance program is also expected to close out in FY 2000, although satisfaction of SEED benchmarks for democratic reforms is not anticipated.

The assistance challenge for all these countries is to ensure remaining funds are focused on the most critical constraints to graduation and that sufficient indigenous institutions are in place to support economic and political integration with the West in general, and the European Union, in particular. Hence, as part of a limited Washington-managed "post-presence" strategy in the CEE, USAID is developing various mechanisms to manage remaining activities and to reinforce the sustainability of results achieved.

One proposed new activity will help to harmonize accounting reform and auditing practices across countries in order to encourage adoption of internationally-accepted standards and facilitate capital flows beyond borders. With the goal of harmonizing banking regulations and practices across the region, and to prepare these countries for EU entry, the Regional Bank Regulatory Assistance will bring together US and other Western bank regulatory practitioners, institutions and regulatory authority with their counterparts in CEE and NIS to discuss experiences related to the development of legal/regulatory framework for the banking sector, supervision issues, and related judiciary issues.

In partnership with several major American foundations, USAID proposes the creation of a publicly- and privately-endowed CEE Trust to continue important civil society linkages with Central and Eastern Europe. Democratic reform in the CEE has spawned a network of non-governmental organizations (NGOs), advocacy groups and professional societies. As these countries approach graduation, however, the challenge will be to ensure the vibrancy and endurance of such organizations absent direct transitional assistance. A trust of the magnitude of approximately \$100 million, funded equally by USAID and U.S. foundations, will be established as a bridge between traditional bilateral assistance and NGO self-sufficiency, and will include new, original grants to both stimulate organizations in-country and to shape hospitable legal and policy climates for their success. The trust will begin operations in countries where USAID is phasing-out and to later be active in Southern Tier countries as civil society matures there. USAID expects to provide \$12.5 million per year for four years, beginning in FY 1999.

Southern Tier: Deepening the reforms. Commitment to reform in the Southern Tier countries for much of the transition years has been uneven and tenuous. As a consequence, the critical, most politically-difficult reforms had been largely pushed aside and the economies were unable to sustain broad-based expansion. Partly as a result of this, however, reform-minded governments (in Bulgaria, Romania, and Albania in particular) are now in positions to re-start the reform process and to genuinely deepen the reforms.

USAID's programmatic challenge is to capitalize on these reform opportunities while drawing on lessons learned from the Northern Tier experiences. This means moving quickly and decisively towards deepening the reforms while the political will remains. Part of this entails melding ongoing grass-roots initiatives with newer national level policy reform programs; linking our

"bottom-up" programs with "top-down" initiatives. This is particularly germane to our local governance and community development programs; such programs can only fully succeed with national government support, and this support has just recently come about in much of the region.

It is also important, in concert with our development partners, to maximize linkages across the reform components. There are strong complementarities and hence possibilities for synergism with an integrative approach. The other side to this is the possibility that insufficient progress in one reform aspect may undermine potential gains from progress of another. Market reforms, for example, need to include privatization measures with a post-privatization program that typically includes five primary components: commercial law development; tax reform; accounting and audit reform; bank reforms; and the development of capital markets.

Finally, the objective of SEED program assistance has been to provide short-term interventions capable of jump-starting the transition process in a manner which contributes to the sustainability of the reforms. Hence, as has been the case in many of our best practices in the Northern Tier, assistance in the Southern Tier needs to increasingly focus on building local capacity through indigenous institutions. This means less reliance on "retail" assistance (or direct support to individual entities such as firms or NGOs), and more focus on "wholesale" assistance (that is, more broad-based, albeit indirect support through the creation of local intermediate support organizations).

Albania: A case in itself. Albania lags considerably in its transition relative to all other CEE countries. Moreover, its economy is qualitatively different. In fact, on the development continuum, Albania in many respects more closely resembles a low-income developing country.

Average income in Albania (measured in purchasing power parity terms) is roughly on par with a handful of Sub-Saharan African economies (such as Uganda, Kenya, and Angola), and comparable to some relatively poor Asian economies as well (such as Cambodia and Bangladesh). The structure of Albania's economy is primitive even by low-income country standards. Agriculture accounts for well over half of output; the developing country average is closer to 33%.

Perhaps more fundamental is Albania's relatively underdeveloped institutions and infrastructure and, from that, its limited absorptive capacity for reform. Albania's institutional development much more closely resembles that of developing countries than transition countries. Among the most daunting challenges is the development of public institutions and governance more broadly. The institutional capacity to carry out basic functions of government such as preservation of law and order, definition and protection of property rights and other judicial functions, central banking and fiscal management, and other means to support private sector activity is severely limited.

The programmatic implications of this situation is that short-term SEED program assistance will not be sufficient to take Albania to program graduation; it will take much longer for Albania to achieve what is being achieved elsewhere in CEE. Albania's unique status as both a transition country and a developing country call for a continued long term program of Development

Assistance funding when SEED Assistance is no longer available. As in other Sustainable Development countries, it is not yet possible to project a realistic graduation date.

Balkans: Advancing stabilization and reconstruction and transition. Progress in the Balkans has proceeded less rapidly than in the Southern Tier. Although our programs have moved from reconstruction, as USAID has achieved significant progress in this sector, to a transition model based on reconciliation and institution-building, continued conflict in Kosovo threatens to embroil this region in war once again.

Although progress continues to be made in Bosnia, many communities are still experiencing hardships brought about by the devastation of war. In addition, refugee and displaced person returns need to be accelerated. The Federation economy is slowly improving, but the economy in the Republika Srpska (RS) is stagnant. Overall, democracy remains fragile. Progress is needed in the reform of the media sector and in the installation of multi-ethnic governments resulting from the September 1997 municipal elections. Given the large problems remaining in the institutionalization process in Bosnia, USAID will continue major support to implementation of the Dayton Peace Accords and cooperation between the entities. As part of that process, assistance toward a market economy and democratic system in Bosnia is consistent with and supportive of USAID's broader goals in the region.

The most important task facing Bosnia continues to be the reactivation of productive capacity to create jobs and income. This requires continued repair of municipal infrastructure and the provision of capital to restart and improve businesses. The resumption of economic activity and gainful employment gives Bosnian citizens a stake in a lasting economic recovery and allows returning refugees, DPs and demobilized soldiers to be reintegrated into their communities. This is especially true in the RS. However, large scale economic investment in the RS remains dependent on increased adherence to the Dayton principles.

Coupled with the economic recovery, remaining needs include building a legal and financial framework and creating a conducive environment for a private sector economy. Both central and entity-level governments need assistance in the development of transparent and accountable budget systems that ensure equitable and need-based distribution of resources. Other legal changes needed are equitable and transparent privatization laws and a resolution of property issues hampering refugee and displaced persons return.

The development of a strong, pluralistic democracy and enduring democratic institutions are key elements to building a peaceful, just and multi-ethnic society in post-war Bosnia. In municipal elections held in September 1997, Bosnian voters turned out in high numbers and distinguished between a myriad of newly formed political parties contesting the elections. More importantly, election results have initiated the implementation of new multi-ethnic municipal councils. The challenges in moving toward a democratic Bosnia are still present, however, particularly in the RS. Though Bosnian election officials have developed the capacity to carry out their responsibilities with minimal international oversight, the administration of elections must be institutionalized as free, fair, and transparent. In addition, progress is needed in the reform of the

political party process and media sector, as well as in supporting the ongoing installation of multi-ethnic governments.

The overall goal of the country program in the FRY is to support the empowerment of citizens to attain political and economic freedom through participatory, democratic processes. Establishing a more open, people-driven democratic society will be a major determinant of the nature of politics and economic development in the FRY, as well as future stability in the region. The USAID program in Serbia and Montenegro is at present still unfolding. However, it is certain that the centerpiece of the USAID program will comprise activities directly supportive of U. S. foreign policy interests and SEED legislation objectives. It will involve efforts to enhance respect for the rule of law, protection of human and civil rights, strengthen civil society and foster individual economic opportunity. Each of these elements focuses on empowerment. They involve choice and participation, which are vital components of the democratic process.

The basic approach in Kosovo will be to support activities that will help bring people and communities together. The key criterion for assistance will be whether the activity will cause Serbs and Albanians to communicate: exchange views, have a dialogue, work together or even sit in the same room together (an uncommon thing today). There are bright spots and situations where communications are happening. These need to be expanded as targets of opportunity.

While improved communications is the principal aim of the Kosovo program, it can be accomplished through community based support to education and health sector activities, and by assisting the media as well moderate leaders and potential leaders through training and conflict resolution initiatives.

E. Significant Initiatives

Global Climate Change: The old trading arrangements of the CEE countries allowed for heavily subsidized energy production and consumption resulting in an energy intensity usage that still far exceeds that of Western industrialized countries. For this reason, USAID's approach to mitigating the ENI countries' contributions to the threat of global climate change (GCC) focuses heavily on energy efficiency and direct emissions reduction. Poland, the largest, most industrialized nation in CEE, is considered a "key" recipient of this assistance. Many other countries in the region also receive USAID assistance in addressing climate change issues.

In many CEE countries, major reforms to improve power-sector efficiency through the development of decentralized competitive power markets have been adopted. CEE bilateral assistance programs are supporting these reforms by improving the legal and regulatory framework for investment and introducing commercial management systems in utility companies. The creation of power markets will lead to more rational energy pricing and improved tariff collection, which will provide incentives for energy efficiency investments. Competitive electricity markets also will improve efficiency and reduce emissions in the region by helping foster the substitution of natural gas for coal as an energy source. USAID industrial and municipal energy

efficiency programs are demonstrating the large potential for savings in heat and electricity, and supporting the development of local energy service companies and associations.

Poland Ukraine Cooperation Initiative: This new FSA-funded initiative involving Ukrainian cooperation with government and private institutions in Poland presents a promising opportunity for Ukraine to benefit from Poland's considerable successes. The initial focus is on business development. This will contribute to strengthening relations among nations in the ENI region and can serve as a model for other efforts to share lessons in transition.

Environmental Partnership Program: The ENI Environmental Partnership Program (EPP) is a program to establish linkages -- professional and financial -- between U.S. and ENI businesses, local governments and trade and professional associations, in order to promote solutions to environmental problems that are appropriate to market oriented economies and democratic societies. EPP is a partnership initiative, not a technical assistance program. The relationships founded under EPP will be designed to outlast USAID assistance, and all partners will contribute resources (in cash and in kind) on a cost-sharing basis.

EPP will also promote new markets for U.S. suppliers of environmental goods and services in the ENI region, producing mutual benefits from technology transfer and sustainable trade and investment relationships. EPP is the ENI Bureau's response to the Administrator's decision to replicate the success of the U.S. Asia Environmental Partnership. EPP will also be an important vehicle for advancing the Administration's Global Climate Change Initiative.

F. CEE Regional Programs

Regional programs are an essential part of SEED program as they are designed to fill a special niche in CEE countries. Regional programs were created to complement and support the bilateral programs. ENI/W regional programs consist of activities that (a) are geographically cross-border in scope; and (b) are managed by or subject to the management oversight of an ENI/W office. This definition embraces the following types of programs: (i) programs whose success depends upon concurrent action and/or cooperation by two or more countries; (ii) workshops, information networks, and institutional support for cross-border sharing of development experience; (iii) assessment/design arrangements whose flexibility and rapid response capability would be impaired if budgeted on a country-specific basis; and (iv) programs intended to extend U.S.-country relationships and reinforce sustainability beyond closure of USAID posts.

ENI is requesting \$7.7 million for work in economic restructuring and growth in Central and Eastern Europe. These funds are for both new and on going programs. In cooperation with the OECD, ENI will begin a new activity aimed at harmonizing accounting reform and auditing practices across countries so as to encourage adoption of internationally-accepted standards and facilitate capital flows beyond borders. The bureau will continue regional arrangements with the Securities and Exchange Commission and National Securities Clearing Corporation to access

high-level talent in response to specialized country needs. The Regional Trade Initiative, co-managed with the Global bureau, will consist of two components: 1) the development of a policy that would be provide for a sound and harmonious legal infrastructure; and 2) transactions facilitation, employing an internet-linked network devoted to trade-matching opportunities between U.S. and foreign companies. The East-West Institute will continue its unique approach to transferring financial skills to the CEOs and other senior management of commercial banks and other financial institutions in the CEE by providing pro-bono services of senior American and European banks. Regional Bank Regulatory Assistance will bring together US and other Western bank regulatory practitioners, institutions and regulatory authority with their counterparts in CEE and NIS to discuss experience related to the development of legal/regulatory framework for the banking sector, supervision issues, and related judiciary issues, among other things. The goal would be to harmonize banking regulations and practices across the region, prepare them for EU entry and include countries who have not graduated from USAID assistance. The Financial Services Volunteer Corps, through the use of volunteers, offers host country counterparts access to individuals with high levels of expertise in specific technical fields. The Chesapeake Associates/3-E-Net will continue to promote advocacy work in the region which promotes the open and free discussion of issues relevant to economic reform.

Regional programs involving energy are focused on: 1) establishing regional power pools; 2) creating competitive privatized power markets; and 3) increasing private investment in energy efficiency. The development of energy regulatory commissions are critical in fostering regional power pools and system integration with EU as well in furthering domestic restructuring and privatization, including foreign investment. Ongoing programs include the ENI regional association of energy regulatory commissions, the utility systems management institute, the Baltic power pool, and the alliance to save energy. The environment, especially as it is affected by economic restructuring is key to successful integration into the West. Ongoing activities include the Environmental Partnership Program and the Global Climate Change initiative (described in previous section).

ENI is requesting \$26.275 million for regional efforts in democracy and social sustainability, and cross-cutting programs and special initiatives. The bulk of this request will fund the start-up of the CEE Trust. The CEE Trust will begin in countries where USAID is phasing-out, to act as a bridge between traditional bilateral assistance and NGO self-sufficiency. The CEE Trust will include new, original grants to both stimulate organizations in-country and to shape hospitable legal and policy climates for their success. Continuing regional democracy programs include efforts to create the appropriate enabling legal environment for the growth of vibrant NGO communities that will be mutually supportive across borders, and funding to maintain the rapid response capability for funding organizations that help strengthen the political process when unforeseen elections occur. Under programs which help to establish better labor unions and to develop a free and independent media, funds are reserved for a variety of purposes including sector assessments, evaluations, and cross-borders workshops in which trade unionists or members of the media are brought together to discuss common issues. Under the rule of law, continuing activities include those aimed at combatting corruption by improving the training of the

judiciary as well as supporting the accession of CEE countries to regional and international bodies and treaties.

Regional cooperation in the area of local government will help to create a basis for sustained excellence in local government and will serve as an important building block for democracy and private markets in transition countries. ENI's strategy seeks to consolidate the gains already made in the region and to provide a foundation from which local governments can become more open, participatory and better able to serve the needs of their citizens. The program encourages ties with other transition countries and with Western institutions, which will provide sustainability after USG assistance is gone. Funds will foster networking across the region to encourage the exchange of ideas and experiences among those institutions and individuals who are committed to improving the performance and accessibility of local governments. A regional conference was held in late 1996 that result in further networking among local government officials region-wide on targeted technical subjects. A local government Website provides a vehicle for information dissemination of technical reports and studies, and facilitates an exchange of best practices in municipal and democratic governance.

In the social sustainability sector, regional funding will focus on establishing and improving medical partnerships, improving family planning, health market reform and labor market transition. Funding in this sector will permit critical cross-border information sharing and linkages.

Cross-cutting regional programs include limited funds for addressing the Y2K problem for program funded activities in ENI/W, participant training processing and monitoring tasks, performance management and evaluations work and disseminating lessons learned across the region.

G. SEED Resource Request

Summary of SEED funds requested: A total of \$382 million for FY 2000 in CEE. This represents an 18% decrease from the FY 1999 Congressional Presentation request. Of this request, \$313 million (82%) are intended for bilateral programs, \$69 million (18%) will be used for regional programs.

Bosnia and the FRY: The SEED budget for Bosnia (\$175 million) and the FRY (\$15 million) encompass 50% of the total request for the region. This represents a decrease of 21% from the level requested in the FY 1999 Congressional Presentation. USAID's work in Bosnia is making a transition from projects that required high investment of capital resources, to activities that are more common in this Bureau -- focusing on economic restructuring and democratic transition.

Economic Restructuring and Growth: Approximately 43% of the non-Bosnia country specific levels requested will be focused on economic restructuring and growth. This is approximately the same per cent requested for FY 1999. The bulk of these resources will be spent on programs that focus on accelerating the development and growth of private sector enterprises in a competitive

environment. To a lesser extent, other foci include creating a more competitive and market-responsive private financial sector, creating a more market driven pricing system for the energy sector, and improving the capability of dealing with environmental pollution in health sector.

Democracy and Governance: Thirty-six per cent of the funds requested for USAID non-Bosnia bilateral programs in CEE will be directed toward activities that promote the growth of democracy and good governance practices compared to 35% of the funds requested for FY 1999. These resources are fairly evenly split between activities that emphasize the development of a vibrant civil society that will be able to effectively influence public policy, and assisting local governments improve their transparency and accountability to their constituents. Also emphasized is the improvement of the judicial system so that it better supports democratic processes and market reforms.

Social Stabilization: A very small portion (4%) of the non-Bosnia country-specific budget will focus on programs aimed at social stabilization. This funding will be used in Romania to improve the health of women and children, and Albania to improve the health care sector in general.

Cross Cutting and Special Initiatives: ENI proposes that approximately 27% of the non-Bosnia budget be used for cross-cutting and special initiatives. This represents a decrease from the 33% requested for FY 1999. These funds will be used to achieve objectives that contribute to more than one strategic objective as well as general training programs. Special initiatives generally include activities that do not contribute directly to strategic objectives, but nevertheless serve U.S. interests. For example, activities implemented by other U.S. agencies which do not directly support USAID's transition program, such as Peace Corps, U.S. Information Agency and are included in the budget as special initiatives.

Field Support Needs: Three missions in CEE countries have committed a portion of their bilateral budget to Global mechanisms. Romania has requested that \$900,000 be directed toward programs in family planning and democracy. Bulgaria will commit \$8,150,000 for Global mechanisms that correspond to economic restructuring and democratization as well as special initiatives. Albania will direct \$2,200,000 of its bilateral budget to Global for work in economic restructuring, social sustainability and special initiatives.

Donor Coordination: Within the context of the Transatlantic Initiative, USAID has coordinated with the World Bank, the European Bank for Reconstruction and Development (EBRD), and the European Union (EU) to leverage hundreds of millions of dollars, *beyond its own contributions*, for the region. In all countries, USAID has provided leadership in bringing other donors together to promote program synergies and coordinate implementation. Donors have been particularly effective when presenting a united front in seeking reform, as was the case in Bulgaria when the reform efforts started to lag. The U.S. Government, and the World Bank and other international financial institutions such as the EBRD sent joint letters to the Government of Bulgaria urging the successful resolution of problems that would permit acceleration of the power sector reform program.

In Bosnia-Herzegovina, the international community is working closely on all aspects of economic recovery, in full coordination with the North Atlantic Treaty Organization (NATO) Stabilization Force (SFOR) mission. The U.S. contribution is expected to be 20% of the total World Bank estimate of bilateral aid needs, while the European Union and its member states continue to contribute the lion's share of these needs. Through regular meetings of the Steering Board of the Peace Implementation Conference, semi-annual convening of the full Peace Implementation Conference, and daily cooperation with the High Representative and World Bank representatives, the United States and its partners seek to streamline the coordination of civilian program implementation.

H. Western Europe Assistance

Summary of funds requested for Western Europe: A total of \$38.6 million is requested for FY 2000 in Cyprus, Ireland and Turkey.

Turkey: The population program for Turkey will require \$4 million in DA funds. This sustainable development program is expected to strengthen the Government of Turkey's policy environment for health care delivery. Activities in this sector include those which facilitate NGO participation, train counselors and care providers to improve the quality of services and depth of knowledge, seek expansion of access to services by integrating them into existing health care delivery networks, and provide funding for contraceptive commodities on a decreasing scale.

Cyprus: In FY 2000 we are requesting \$15 million in Economic Support Funds for Cyprus. These funds will support two major efforts: 1) the bicomunal development project aimed at funding activities which accrue benefits to both sides of the island; and 2) scholarship and training programs with particular attention to conflict resolution and negotiation activities. The training will target community leaders, politicians, returning scholarship participants, members of local advocacy groups and local nongovernmental organizations.

Ireland: The FY 2000 request for the International Fund for Ireland is \$19.6 million in Economic Support Funds (ESF). The Fund was formally established as an independent entity in December 1986, in keeping with the provisions of the Anglo-Irish Agreement of November 1985. The overall objectives of the Fund promote economic and social advancement and encourage contact, dialogue, and reconciliation between nationalists and unionists throughout Northern Ireland and the six border counties of the Republic of Ireland. The Anglo-Irish Agreement states that the Fund should accomplish these objectives by stimulating private investment and encouraging voluntary efforts with special emphasis on projects promoting communal reconciliation.

IV. R4 PROCESS AND SO CLUSTERING

A. Setting Country Request Levels:

ENI's R4 process begins with communication of country resource levels for planning purposes. Country levels are established by the respective State Coordinators' Offices in close consultation with ENI Bureau leadership. In general, levels reflect the foreign policy importance of the ENI country and prospects for achieving economic and political reforms, particularly based on relative commitment of recipient governments. Several other region-specific factors influence country levels. Most important among these are:

NIS: Congressional earmarks (Ukraine, Armenia, and Georgia), Congressional restrictions on assistance to governments (Ukraine, Russia), trans-Caspian oil and gas interests, second-stage assistance strategies (partnerships, regional investment initiatives, shift from government-based programs to community-based programs).

CEE: Resource needs of Bosnia and Serbia (special foreign policy programs that employ different planning/performance review procedures); shift of resources to the Southern Tier as Northern Tier countries approach graduation; resource response to changes in government that improve prospects for reform (Albania, Bulgaria, Romania); projected time frame to graduation.

B. ENI's R4 Process

Within designated country levels, ENI Missions organize their R4 submissions along priorities established in strategic plans which, per Bureau policy, are closely aligned with ENI's Strategic Framework and statutory directives to help ENI countries achieve market-based democracies. Missions have considerable latitude to allocate resources among economic growth, democracy, and health/social strategic objectives according to progress to date, future needs, and prospects for producing results.

Some programming constraints nevertheless apply. Mission resource requests must accommodate high-priority programs managed by other organizations (e.g., Enterprise Funds, FAA Section 632(b) arrangements with other USG agencies, etc.), Congressionally-mandated programs (NIS health earmarks), and ENI contributions to overall USAID Global Climate Change targets. CEE countries are expected to reflect greater program concentration and refinement of SO achievement targets as they move closer to graduation dates. NIS countries are expected to increase emphasis on New Partnership Initiatives. For NIS countries, future resource priorities also emerge from periodic program reviews held with the Coordinator's Office, particularly in light of Congressional holdback restrictions on Russia and Ukraine. ENI's standard R4 review procedures place lead responsibility with Program Objective Teams (POTs), organized around objectives in ENI's Strategic Framework. POTs are asked to do the following:

- assess strategic objective (SO) performance for SOs that correspond to their respective areas -- either confirming the post's self-assessment or presenting the POT's rationale for a different rating;

- for SOs that have performed below expectations, assess the post's proposed management actions, prospects for improved performance through FY2000, and proposed resource allocation;
- resolve differences with the post through communications and/or meetings with post representatives;
- forward unresolved issues on performance, prospects, and funding to the AA/DAA-chaired program review.

A time-saving variation on the standard R4 review process is ENI's informal R4 review, applied to roughly one-half of R4 submissions. This review is conducted by a small ENI staff group, augmented by representatives from PPC, M, and G Bureaus. The review group serves in lieu of POTs in assessing SO performance and reviewing the future scenario for poor-performing SOs. POTs are invited to provide their perspective on SO performance and program issues, but POTs do not routinely hold meetings unless the review group requires their views on SOs that have performed below expectations. AA/DAA-chaired reviews are not convened unless there are unresolved issues that require management attention. (This year, we scheduled informal reviews for CEE countries nearing graduation, W/NIS countries in view of quarterly program reviews with the State Coordinator, and Bulgaria, whose strategic plan had been reviewed in December.)

C. Clustering Strategic Objectives

Following USAID R4 guidance, ENI used common factors and weights to group (cluster) SOs into a top quartile, middle half, and bottom quartile to focus special attention on bottom-quartile SOs in considering management plans and resource allocations. As shown in Table 6 (Composite Clustering), SOs were clustered by ENI goal area (economic growth, democracy, and health/social sector) and sub-region (CEE and NIS). The ENI clustering process is further detailed below:

Performance (50%): ENI used a three point rating: "3" for SOs that exceeded expectations, "2" for SOs that generally met expectations, and "1" for SOs that underperformed. In instances where the POT disagreed with the post's self-assessment, ENI's used the POT's rating unless the post presented compelling justification for its rating. In some cases, performance ratings were shaded to the downside, "2.5" or "1.5" because of lagging performance on an important intermediate result (IR).

Need/Partnership (30%): As last year, ENI used its Monitoring Country Progress indices to assign a composite need/partnership rating to ENI countries. The standard PPC method for rating country need (based on income per capita, infant mortality, and total fertility) is not relevant to country conditions and transition strategies for most ENI countries. PPC's partnership index is more relevant to ENI countries, but ENI's indices use the same Freedom House assessments of political rights/civil liberties and a broader array of economic policy reforms to assess commitment.

For ENI, country need and quality of partnership are inversely related. Countries that are most advanced on the economic and political reform spectrum (transition line) manifest higher quality of partnership but, in general, less need for additional assistance. Countries at the low end of the spectrum have the greatest need for economic and democratic reforms, but their uncertain commitment/partnership makes them the riskiest bet for achieving results with our assistance. Countries in the middle of the spectrum have a compelling combination of need and enlightened partnership.

Accordingly, ENI rated need/partnership as follows:

Middle-countries (workable commitment/significant need): "3"

High-end countries (high commitment/low need): "2"

Low-end countries (low commitment/high need): "1"

(To address exceptions, we made downward adjustments of one point for countries in the middle group where economic and/or democratic reforms have stalled or regressed.)

Objective's Contribution to U.S. National Interest (10%): In their R4s, posts clarified the linkages between their SOs and U.S. interests defined in the Embassies' Mission Performance Plans. Per USAID R4 guidance, SOs contributing to the highest priority national interest received the top-rating of "3", SOs contributing to the second or third ranked national interest received a "2" rating, and all others received a "1".

Foreign Policy Significance of the Country (10%): Based on the relative importance of each country to U.S. national interests of security, economic prosperity, advancing democracy, and global issues, we assigned ratings of "3", "2", or "1", with a "3" rating for countries of highest importance.

D. Rationale for Funding SOs in the Lowest Quartiles

1. NIS Economic Growth SOs

Scorecard: 36 SOs in goal area; 9 bottom-quartile SOs; 8 bottom-quartile SOs had low performance ratings. (In FY 2000, ENI requests \$270 million for this assistance area, of which 20% is allocated to SOs in the lowest quartile.)

Russia SO 1.2-Reformed Tax System: Failure to pass a new tax code in 1997 stalled progress on tax reform. Progress on this SO is considered critical to the overall economic growth strategy, and proposed tax legislation assisted by USAID will provide a much-needed foundation for improvements in the tax system. POT 1.2 recommended that Mission plans should include budget management and tax administration. Within available resources, the Mission's program has the flexibility to address tax administration and improve the government's revenue and expenditure estimation capabilities.

Turkmenistan SO 1.2-Improved Fiscal Policy/Management: While the Mission rated performance as "meeting expectations", it noted that Turkmenistan remains the one Central Asian Republic without an IMF program in place and 50% of all government expenditures are off-budget. Nevertheless the Mission is encouraged by recent indications of GOT willingness to negotiate an IMF program, which would establish a supportive environment for improving the government's fiscal policy and budget management.

Azerbaijan SO 1.3-Private Enterprise Development: While the Mission has not yet developed a results framework for this SO and therefore did not rate its performance, POT 1.3 concluded from the Mission's narrative report that the SO is probably not meeting expectations, particularly on small/medium enterprise financing. The POT recommended much greater emphasis on agricultural enterprise in future planning. The Mission will address these issues in a strategic plan due late 1998.

Georgia SO 1.5-More Economically Sustainable Energy Sector: While overall SO progress has not met expectations, several developments provide basis for confidence in improved future prospects: a June 1997 Electricity Law that established an independent Electricity Regulatory Commission, an October 1997 Presidential Decree that includes measures consistent with USAID's strategy for energy sector reform, and GOG actions to privatize the Tbilisi electricity distribution network. Accordingly, POT 1.5 endorsed the Mission's future plans and resource allocation.

Ukraine SO 1.5-Improved Energy Sector: Over the past year, the GOU continued to delay privatization and reforms in tariff rates/collections in the electrical energy system. However, the GOU's recent approval of a Financial Recovery Program (FRP) greatly improves prospects for future progress, resumption of a World Bank Electricity Market Development Loan, and a critical role for USAID in FRP implementation. POT 1.5 and the Mission agreed that USAID's program should focus on strengthening the role of the electricity regulatory commission and helping distribution companies improve revenue collections and prepare for privatization. Necessary resource levels for this SO will be reviewed in Fall 1998, in relation to the pace of FRP implementation.

Armenia SO 1.3-Private Enterprise Development: Progress did not meet expectations on several key performance measures: private sector share of employment, private sector exports, foreign direct investment, and increased investor confidence. Nevertheless the Mission noted that many USAID-financed activities are meeting their targets. POT 1.3 recommended much greater emphasis on agricultural enterprise to improve prospects for future results. The Mission will address these issues in a strategic plan due late 1998.

Uzbekistan SO 1.3-Private Enterprise Development: The GOU has been slow to complete initial documentation for accession to the World Trade Organization (WTO). Further, GOU foreign exchange controls and restrictive trade/investment policies worsened the investment climate in 1997. The Bureau endorsed the Mission's plans to center its policy reform initiatives around a WTO accession support program. Mission commitment of resources will be closely linked to

evidence of government will to proceed with reforms. If the GOU does not manifest that will, USAID support will be phased down.

Uzbekistan SO 1.4-Improved Financial Sector: Progress has been impeded by distortive foreign exchange policy, controls on local currency accounts, and government dominance in securities market regulation. Nevertheless the Mission's program has helped strengthen the Central Bank's capabilities in bank supervision. The Bureau endorsed the Mission's plans to continue pressing for removal of distortions in monetary policy, improved bank supervision, and independent securities market regulation. The Mission has established progress benchmarks that must be met before committing significant additional resources to this SO and communicated this de facto conditionality to the GOU.

Turkmenistan SO 1.3-Private Enterprise Development: Progress on this relatively new SO has been impeded by continued dominance of state-owned enterprises in the economy and a restrictive trade/investment climate. Recent establishment of a new GOT privatization unit and renewed GOT interest in World Trade Organization accession may provide openings for more effective USAID support programs. The Bureau endorsed continued USAID efforts under this SO, with the understanding that a sluggish GOT response to policy reforms could result in discontinuation of assistance.

2. NIS Democracy SOs

Scorecard: 15 SOs in goal area; 4 bottom-quartile SOs; 3 bottom-quartile SOs had low performance ratings. (In FY 2000, ENI requests \$67 million for this assistance area, of which 15% is allocated to SOs in the lowest quartile.)

Georgia SO 2.3-Improved Local Government: Progress has lagged expectations because of GOG delay in holding local elections and establishing a legal framework for local government operations. However, POT 2.3 and the Mission agree that other developments have improved prospects for future results, especially anticipated 1998 elections for local councils and increased participation of citizens advisory groups in local government affairs. Improvements to the SO plan will be further considered in the country strategic plan due late 1998.

Uzbekistan SO 2.1-Increased Citizens Participation: Given Uzbekistan's restrictive, centrist government, performance targets were set conservatively and limited expectations were met. The GOU has permitted the registration and development of NGOs that do not push a political agenda, but a new NGO law is stalled in the Ministry of Justice. The GOU allowed the number of electronic media stations to grow significantly but still curbs political commentary. In this context, the Bureau endorsed the Mission's continued emphasis on strengthening NGOs as the most promising avenue for peoples' participation.

Armenia SO 2.1-Increased Citizens Participation: Progress has lagged expectations because of a flawed Presidential election process and limited capacity of political parties to respond to constituent needs. POT 2.1 agreed with Mission plans to target problem areas to increase citizen

confidence, with emphasis on a more transparent electoral process and political party development. The POT also recommended that the Mission consider a parliamentary assistance program if 1999 parliamentary elections are fairly conducted.

Tajikistan SO 2.1-Increased Citizens Participation: POT 2.1 found it difficult to assess SO performance because the Mission recently changed most performance measures as it refocused SO plans to facilitate the peace process and national reconciliation. The assistance programs for NGOs and independent media are still in incipient stages, with prospects for GOT receptiveness and supporting legislative initiatives yet to be determined. The Bureau endorsed Mission plans under this SO, with near-term emphasis on the electoral process and return of expatriates to Tajikistan with full political rights.

3. NIS Health/Social SOs

Scorecard: 9 SOs in goal area; 3 bottom-quartile SOs; 1 bottom-quartile SO had a low performance rating. (In FY 2000, ENI requests \$90 million for this assistance area, of which 24% is allocated to SOs in the lowest quartile.)

Azerbaijan SO 3.1-Reduced Human Suffering: The Mission has not yet developed a results framework for this SO and therefore did not rate its performance. Based on the narrative activity report, POT 3.1 was similarly unable to provide a performance rating. Given persistence of humanitarian problems, the POT urged continuation of this SO. Plans and performance measures will be detailed in the country strategic plan due late 1998.

Georgia SO 3.1-Reduced Human Suffering: POT 3.1 did not agree with the Mission that this SO had met expectations. The GOG has made little progress toward the intermediate result (IR) of more effective safety net institutions, and termination of support of community development assistance will likely affect progress towards the IR of self-help by vulnerable households. Moreover, the planned transition from humanitarian assistance to health and social sector reform was not clearly articulated. These issues will be examined in the country strategic plan due late 1998.

Tajikistan SO 3.1-Reduced Human Suffering: Despite lack of data on SO-level indicators, POT 3.1 and the Mission agreed that progress under this SO had generally met expectations. The SO's placement in the bottom quartile is the result of non-performance factors. The POT endorsed the Mission's plan to conclude this SO over the next two years, to be succeeded by a health/social sector reform SO. POT representatives will assist the Mission in detailing this transition strategy.

4. CEE Economic Growth SOs

Scorecard: 9 SOs in goal area; 3 bottom-quartile SOs; all bottom-quartile SOs had low performance ratings. (In FY2000, ENI requests \$70 million for this assistance area, of which 27% is allocated to SOs in the lowest quartile.)

Romania SO 1.1-Increased Transfer of State Assets: The GOR managed to privatize only 1300 of the 2200 state enterprises targeted for 1997. Nevertheless POT 1.1 and the Mission agree that prospects are excellent for meeting future targets and concluding Mission support to small/medium enterprise privatization by late 1999. The legal framework, initially delayed, was enacted in December 1997, and USAID advisors have helped strengthen the GOR's Privatization Operations Center. The bureau endorsed the Mission's plans and resource request.

Albania SO 1.3-Private Enterprise Development: Like other Albanian SOs, progress was interrupted by the breakdown in civil order in 1997, followed by security problems that slowed the return of many USAID-financed advisors to Albania and subsequently restricted in-country travel. These security problems are expected to ease, and the reform orientation of the current government promises a more favorable business environment. Despite security problems, performance in strengthening trade associations exceeded expectations in 1997.

Albania SO 1.4-Improved Financial Sector: Since deficiencies of the financial sector (particularly collapse of the unregulated pyramid schemes) led to the civil disorder of 1997, it is understandable that SO 1.4 performed far below expectations. The Mission's strategic plan, reviewed in tandem with its R4, lays out a cogent plan for strengthening operations of and public confidence in the financial sector. Emphasis will be on bank regulation, restructuring of publicly-owned banks, liquidation of insolvent non-bank financial schemes, and establishing the underpinnings of a capital market system.

5. CEE Democracy SOs

Scorecard: 9 SOs in goal area; 3 bottom-quartile SOs (all Albanian); the bottom-quartile SOs had low performance ratings). (In FY2000, ENI requests \$75 million for this assistance area, of which 15% is allocated to SOs in the lowest quartile.)

Albania SO 2.1-Increased Citizens Participation:

Albania SO 2.2-Improved Legal Systems:

Albania SO 2.3-Improved Local Government:

USAID/Albania's Democracy SOs performed below expectations because of the civil disorder of 1997 and ensuing security problems. The reform orientation of the new government, its receptivity to people's participation, work towards the country's first Constitution, and the GOA's apparent willingness to address corruption all augur well for achieving results under these complementary SOs. At POT 2.1's recommendation, the Mission modified its budget plans to provide \$500,000 for civil society development in FY2000. Otherwise the Mission's SO plans and resource requests were endorsed in the Bureau's recent review of the country strategic plan.

6. CEE Health/Social SOs

Scorecard: 3 SOs in goal area; 1 bottom-quartile SO, with a low performance rating. (In FY2000--excluding Bosnia, ENI requests \$6.6 million for this assistance area, of which 15% is allocated to the bottom-quartile SO.)

Albania SO 2.3-Improved Social Benefits and Services: Like other Albanian SOs, performance on health/social benefits and services suffered from the civil unrest and continued high levels of violence throughout the country. There have been recent, reassuring signs of stability and restoration of order necessary for the health care delivery system to function normally. The Mission's SO plan and resource allocation were endorsed during recent review of the country strategic plan.

E. Pipeline Management

For NIS countries, the State Coordinator's Office, ENI/W, and Mission representatives jointly reviewed pipelines in early 1998, prior to submission of R4s. Applying the USAID procurement standard that forward-funding (pipeline) should not exceed 24 months of contractor/grantee needs, implementation arrangements that exceeded that standard were trimmed back. OP also placed on its deobligation list all contracts/grants that are nearing their completion dates with funds in excess of remaining needs.

For CEE countries, a systematic pipeline review was not possible because of gaps in accounting data. On ad hoc basis, ENI/OIM staff assisted several CEE countries nearing graduation to assess pipelines and prepare deobligation schedules.

F. Streamlining the R4 Process

For this year's R4 reviews, ENI introduced procedural changes to enhance the technical quality of reviews and economize on staff involvement across the full review cycle. Informal feedback from ENI staff suggests that we were successful in reducing the huge workload associated with R4 reviews in 1996/1997. Following BBS completion, we will canvass ENI/W POTs and offices, overseas posts, and central USAID participants to obtain views on the revamped R4 process, including real time savings realized. The most significant changes are detailed below:

Standard R4 Review:

- eliminated a PCS-chaired issues meeting (in past years, this meeting involved 30-40 persons for 2-3 hours);
- relied on POTs to resolve issues to the extent possible through communications/meetings with Missions;

- concentrated reviews on central R4 concerns: SO performance, prospects, and results-based budgeting;
- replaced the traditional issues paper for AA/DAA-chaired reviews with a 1-2 page agenda outline and attached draft cable;
- eliminated a wrap-up meeting with the AA/DAA (in past years, this one-hour meeting involved 7-10 persons).

Informal R4 Review:

- relied on a small staff group to carry out essential functions of an R4 review (saving an average of 5-8 POT meetings per country program);
- eliminated PCS-chaired issues meetings;
- eliminated AA/DAA-chaired review meetings (these meetings normally involve 30-40 persons for two hours);
- did not require Mission representation in USAID/W (saving week-long TDYs for 2-3 persons, on average).

V. WORKFORCE AND OPERATING EXPENSES

The graduation of a number of countries coupled with stronger overseas missions will enable us to reduce ENI staffing over the next two years, particularly in Washington. Direct hire staff will decline from 263 in FY 98 to 238 in FY 2000 with the reduction of 25 USDH in ENI/W. The resulting level is below the BBS target for both overseas and Washington direct hire staff. This continues a trend in ENI/W USDH staff reductions which, over a five year period, will see USDH levels decreasing by 47% from FY 1995 to FY 2000. Similarly, ENI/W PSC staff will decline from 91 in FY 98 to 71 in FY 2000. Overall staffing in all categories will be reduced by 137 employees (11%).

These reductions will allow us to virtually hold the line on OE requirements in both FY 99 and FY 2000. Our Washington OE needs will decline from the FY 98 level of \$1.7075 million to meet the target figure of \$1.630 in FY 99 and FY 2000. Overseas, our OE requirements increase only modestly despite significant expected inflation. Our FY 2000 requirement is for \$40.728 million, which is less than 3% above our estimated FY 98 amount and less than our requirement for FY 99. Requirements in FY 99 are slightly more at \$41.204 million but again, only a modest 4.5% above FY 98.

The amount requested by ENI overseas missions and offices exceeds the BBS target level by \$2.6 million in FY 1999 (6.74%) and \$2.1 million in FY 2000 (5.4%).

	BureauRequest FY 1999	Change from FY 1998	M Bureau Level	Shortfall
Overseas	\$41,204.4	\$1780.0	\$38,610.0	\$2,594.4
Washington	1,630.0	-77.5	1,630.0	-0-
TOTAL	\$42,834.4	\$1702.5	\$40,240.0	\$2,594.4

	Bureau Request FY 2000	Change from FY 1999	M Bureau Level	Shortfall
Overseas	\$40,728.0	\$ -476.4	\$38,610.0	\$2,118.0
Washington	1,630.0	-0-	1,630.0	-0-
TOTAL	\$42,358.0	\$ -476.4	\$40,240.0	\$2,118.0

Despite continuing to administer programs and activities in a cost effective manner, and despite planned staff reductions that will bring us below the staff ceilings set by M, we need slightly more OE than the OE target set by M at 2% below the projected FY 1998 actual amount for FY 1998 for the following reasons:

1. Planned staff reductions are primarily in Washington where they result in reduced OE costs to USAID, but little in reduced OE costs to the ENI OE budget because USDH salaries are not reflected in bureau budgets;
2. A State Department salary survey report for Moscow authorizes a 60% across the board salary increase for FSN staff there. This is expected to go into effect in October 1999. Also required is the institution of USG-funded payments into local social security funds of 39.5% of salaries. These two changes increase our Russia OE needs by \$1 million in FY 99 and FY 2000.
3. Housing costs are increasing due to inflation. For example, many early residential leases are now having to be replaced with significantly higher leases and this is further exacerbated by the increase in staff that is finally arriving to fill the long vacant positions. This is particularly evident in: the CAR region where rentals are projected to increase by \$250 thousand, Russia, with increases of \$200 thousand, and Ukraine, higher by \$275 thousand.
4. Both office and residential utility costs are similarly escalating. Costs in this category are more than \$300 thousand higher in the Caucasus region alone.
5. FSN salary costs are also significantly increasing with a resultant high turnover of personnel where local salary levels do not keep pace. In addition to the large increase in such costs in Russia, these salary costs are projected to go up by \$325 thousand in Bosnia, \$400 thousand in the Caucasus, and \$500 thousand in the CAR region.

With the understanding that OE funding will be limited for the Agency as a whole, the ENI Bureau has continued to make every effort to use our special legislative authorities to administer and support our activities with program funds. Scrutiny of the allocation of costs between program and OE is considered a routine part of the R-4 process and is undertaken at all levels of management within ENI. With pressures to keep staffing and OE funding levels low, ENI is finding it more difficult to manage levels of program resources that are now more than \$7.9

million per USDH or OE funded USPSC. Without OE levels being increased by the small amounts being requested, our ability to properly and effectively manage our programs and activities will be constrained.

The requested budget levels do not include possible costs that may have to be borne in FY 1999 and/or FY 2000 because the need for funding these costs is uncertain. They could however, become a reality. The costs relate to the following:

Additional costs to address Agency Y2K computer compliant issues could be as much as \$500,000 above the funds we have budgeted.

It is possible that an office will need to be established in Montenegro as early as FY 1999; and even though it would be small, the costs would range near the \$500,000 level.

With the organizational changes in the Caucasus, expansion of activities in Azerbaijan could require additional supporting OE resources estimated as high as \$700,000.

Without 636(c) funding being available within the Agency, construction of additional housing on the USG compound in Albania may need to be covered, possibly at a level that could be as high as \$400,000.

Finally, additional resources could be required to cover ICASS payments to the Department of State. FY 1998 being the first year of the ICASS arrangement, the budget is currently based on preliminary levels that could materially increase and similarly affect FY 1999 and FY 2000.

ENI/PCS: July 10, 1998
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